

China's Auto Sector Development and Policies: Issues and Implications

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Summary

The automobile industry, a key sector in China's industrialization and modernization efforts, has been developing rapidly since the 1990s. In recent years, China has become the world's largest automotive producer, with annual vehicle output of over 18 million units in 2011. China is now also the world's biggest market for automobile sales. Meanwhile, China's auto sector development and policies have caused concerns in the United States, from automotive trade, China's failure to effectively enforce trade agreements and laws, to market barriers and government policies that increasingly favor Chinese manufacturers, which could affect business operations and prospects of international companies doing business in (or with) China.

China's auto industry has developed extensively through foreign direct investment, which has come in the form of alliances and joint ventures between international automobile manufacturers and Chinese partners. These international automobile manufacturers, who generally dominate the higher end of the Chinese market, have focused on making cars for China's large and fast-growing market. The domestic Chinese automakers, who occupy the lower end of the market, struggle to improve design and quality to expand sales overseas.

China exports and imports relatively few vehicles. Most of the cars produced in China stay in China and its vehicle exports are mostly light trucks and passenger cars shipped to developing country markets. Automotive trade between the United States and China has increased in recent years, primarily in auto parts. In 2011, the United States imported over \$12 billion in auto parts from China, making it the second-largest source of auto parts for U.S. imports (behind only Japan). Many of these imported parts are aimed at the aftermarket, as most of what China exports to the U.S. market now are standard products such as brake parts and electrical parts. But with high rates of investment and growth in China by the leading U.S. manufacturers of both cars and parts, major motor vehicle companies are increasingly sourcing parts from China.

There have been a number of auto sector trade disputes between the United States and China, addressing issues such as China's implementation of its WTO obligations, failure to implement an effective IPR enforcement regime, market barriers such as high tariffs on vehicle imports, export restrictions of raw materials such as rare earths, and various forms of government assistance to domestic auto and parts companies, such as tire producers.

An emerging issue is that the Chinese government's policies and measures are becoming increasingly restrictive towards foreign auto companies, while at the same time giving preferential support to its domestic car makers. As the central government designates clean-energy vehicles and their components as one of the seven "strategic and emerging" industries (in which it aspires to become a world leader), foreign companies, such as GM, reportedly have been pressured to transfer technology and/or help their Chinese partners to develop these new technologies. These new restrictions and conditions imposed by the Chinese government have caused concerns among global auto companies regarding the business environment in China and how these measures may affect their business operations, growth plans, and competitiveness.

This report provides an overview of China's auto sector development: vehicle production, sales, market drivers, foreign and domestic manufacturers, and automotive trade. It examines how the Chinese government policies and measures guide and often direct China's auto sector development. In addition, this report discusses the prospects and implications for global automakers operating in China.

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Introduction¹

One of the most significant developments in China's industrialization is the growth of China's automotive industry, which is a catalyst for many other linked sectors of its economy. China's focus on its auto industry and the supporting infrastructure and development patterns could have significant implications for global auto manufacturing and trade.

While the U.S. automotive market was impacted by the global economic downturn that started in late 2008 and throughout 2010, the Chinese auto market has been growing rapidly. It has been a bright spot for foreign auto makers with a presence in China, such as General Motors (GM) and Volkswagen (VW). Spurred by the central government's stimulus spending and financial incentives to encourage vehicle ownership, the Chinese vehicle production was over 18 million units each in 2010 and 2011. In the span of just a few years, China has become the world's top auto producer and also the biggest auto sales market.

It is not clear whether China will mainly consume automobiles in its own market, take a more aggressive export-oriented approach similar to that of Japan and Korea, or create some mixture of these two. Industry data and forecasts suggest that China may take a hybrid approach that focuses on domestic consumption while also building vehicles for export in order to induce Chinese companies to produce world class cars. Additionally, China's automotive parts manufacturing sector is export focused, increasingly complex, and rapidly moving from low-cost to more value-added production.

As China becomes a bigger player in the global auto market, its impact on the domestic U.S. industry could increase. So far the most significant impact may be in automotive parts exported into the United States. While U.S.-China trade in motor vehicles is relatively limited, and likely to remain so for the short- to medium-term, bilateral trade in auto parts has grown significantly since 2001.

The Obama Administration has taken direct measures to address U.S.-China automotive trade, such as the tariffs on Chinese tires. However, as China becomes a top automotive manufacturer and a major consumer market, there are lingering concerns about the conditions under which U.S. manufacturers must compete with Chinese firms both in and outside China, including the domestic U.S. market. These concerns have focused on such issues as

- China's export restrictions on certain raw materials, including rare earths, which are necessary for many auto parts production, including those for use in hybrid and electric cars;
- China's incomplete implementation of its commitments as a member of the World Trade Organization, especially with respect to domestic content rules, protection of non-Chinese firms' intellectual property rights, and technology transfer requirements;
- the extent to which Chinese firms are subsidized or otherwise supported and protected by the government when they compete with foreign companies domestically and with imports into China; and
- the implications of China's recently announced restrictions on foreign carmakers' expansion in China amid the government's efforts to promote domestic

¹ John Williamson and Mike Donnelly of the CRS Knowledge Services Group assisted in the preparation of the data for this report, especially the global production and trade data.

producers, for example, how they may affect U.S. auto companies' profitability and business prospects in China.

This report provides an overview of China's auto sector development, including vehicle production, sales, market drivers, manufacturers, and automotive trade. It discusses the operations of foreign auto makers in China, the emergence of domestic manufacturers, and the relationship between the two. It also examines how the Chinese government policies and measures guide and often direct the evolution of China's auto sector and discusses the prospects and implications for international automakers operating in China.

Overview of China's Automotive Industry

China's automotive industry was established in the 1950s, under the guidance of the Chinese Communist Party Central Committee and with assistance from the former Soviet Union. Although the automotive industry has always been viewed as a strategic sector to move the country into the modern industrial age, it did not substantially develop until the late 1980s, after Chinese leader Deng Xiaoping came to power and moved the country toward economic and trade liberalization.² In 1988, after a visit to China and its fledgling automotive industry, then-Chrysler Corporation CEO Lee Iacocca is said to have reflected that China's modernization process would be, "A long haul. A very long haul."³

Since the late 1980s, Chinese vehicles have become increasingly sophisticated as a result of partnerships with major foreign automakers (e.g., VW, GM, Toyota, Honda, Nissan, Mazda, Hyundai, and Kia) designed to foster "cooperation in technology development." An activist government policy has liberalized the Chinese automotive sector in some key respects such as permitting foreign investment, but it requires foreign manufacturers to undertake joint ventures with local partners in order to obtain market access. The stated goal of the Chinese government then was to create a market dominated by a limited number of internationally competitive joint venture assemblers, supplied by local parts manufacturers, and producing to world standards.

After nearly three decades of rapid economic growth, the domestic Chinese auto industry has made substantial progress. Many independent domestic automotive manufacturers have emerged and have ambitions to become global auto companies. Although they have to overcome hurdles, such as creating their own designs and meeting world standards in terms of product quality, safety, and environmental features, the domestic manufacturers are expanding their market share and are slowly moving up the value chain.

China's annual vehicle output increased from less than 2 million vehicles in the late 1990s to over 18 million in 2011. Its auto industry is already a major force propelling the Chinese economy and its workforce, with an annual gross output of more than Rmb 3 trillion yuan (approximately \$ 440 billion) in 2009 and over 3.7 million workers in automotive production, according to China's auto industry association and official.⁴

² "About FAW, History," entry at China First Automobile Works (FAW) Group Corporation website, http://www.faw.com/webcontent/aboutfaw.jsp?pros=history_forword.jsp&phight=550&about=History, as viewed on August 17, 2009.

³ Quoted in Jim Mann, *Beijing Jeep: A Case Study of Western Business in China* (Boulder, CO: Westview Press, 1977 ed.), p. 296.

⁴ The Renminbi (RMB or Rmb) is the official name of China's currency and the yuan is the primary unit of the RMB. The exchange rate used for conversion is 6.82 yuan/dollar; <http://auto.ifeng.com/news/expreview/20100719/375175.shtml>; <http://finance.china.com.cn/special/lianghai2012/20120306/573667.shtml>.

China Becomes a Top Motor Vehicle Producer

The World Leader in Vehicle Output

Figure 1 illustrates the speed with which China has become one of the world's top automotive manufacturers. China first produced more than 2 million vehicles, of all types, in 2000. Since then, it surpassed South Korea (in 2002) and France (not shown on graph, in 2003). With nearly 5.8 million units of total production in 2005, China approached the production level of Germany, Europe's largest national producer and then-number three in the world, and eventually, overtook Germany for third place in 2006. Since then, China's vehicle production has accelerated, passing the 7 million mark in 2006 and approaching 9 million units in 2007.

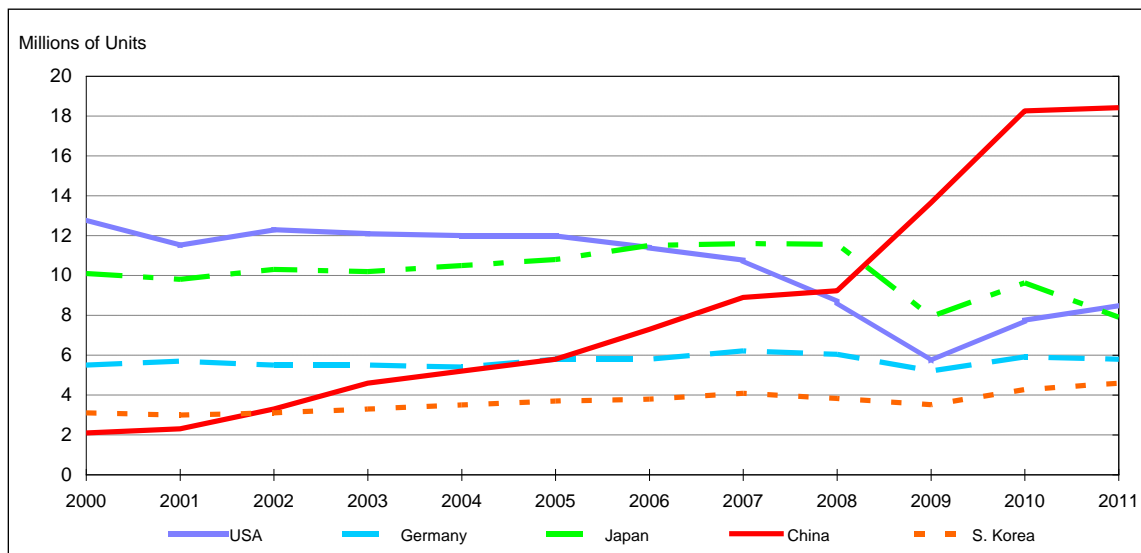
From late 2008 throughout 2009, with the global economy mired in an economic slowdown, global vehicle production dropped more than 10 million units in 2009 from the record high of over 72 million units built in 2007. The impact of the downturn was particularly pronounced for U.S. automakers, with two major U.S. companies, GM and Chrysler, filing for bankruptcy and restructuring their operations. China's automotive industry, on the other hand, showed considerable strength and continued to expand. With an output of 9.5 million vehicles in 2008, China overtook the United States in total vehicle production for the first time and became the second-largest motor vehicle producer—trailing only Japan, which produced 11.6 million vehicles that year.⁵

An economic stimulus package initiated by the government in 2008 enabled China's auto industry to continue its rapid growth in 2009 and 2010. In 2009, China produced more than 13.6 million vehicles, overtaking Japan to be the world's largest producer. In 2010, the growth momentum continued, bringing China's vehicle production to nearly 18.3 million units, almost doubling its 2008 output.⁶ Moreover, among the leading vehicle producers, China has been the only one showing substantial and continuous growth in production levels since 2000, though its growth seems to have flattened in 2011.

⁵ *Ward's Automotive Yearbook 2009*, p. 5.

⁶ *Ward's Automotive Yearbook 2010-11*, p. 5.

Figure 1. Leading Motor Vehicle Production
(Total Annual Vehicle Production, 2000–2011)



Source: Automotive News Market Data Book, 2002; Global Market Data Book, 2004-08; *Ward's Automotive Yearbook*, 2009-11; IHS Automotive, 2011 Global Vehicle Production; Chinese Ministry of Industry & Information Technology (MITT), 2011 Auto Sector Summary (Jan 19, 2012).

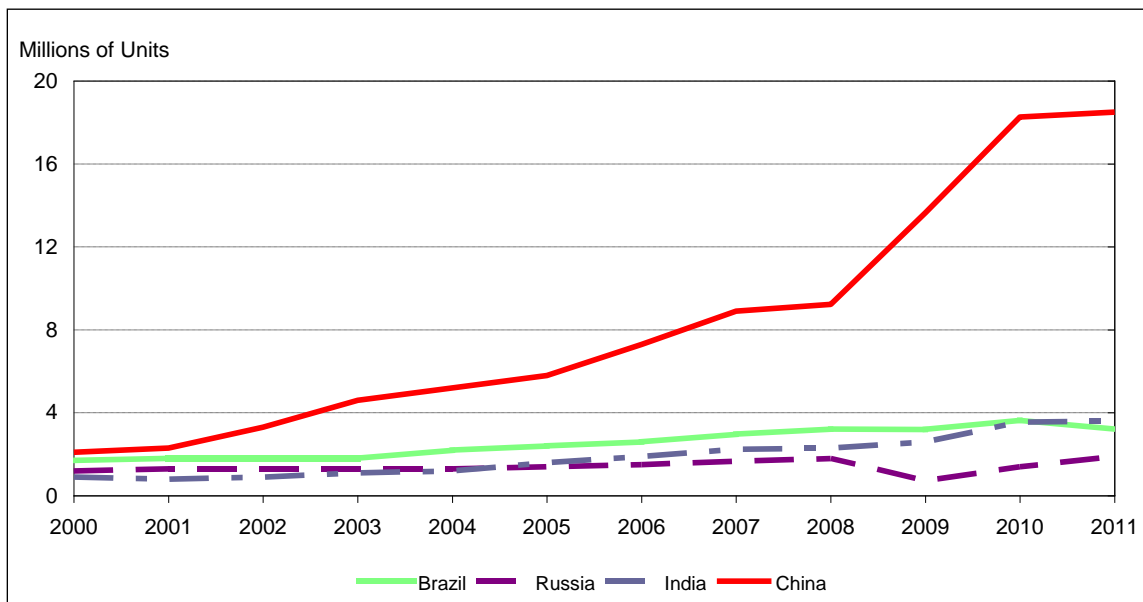
Notes: Vehicle production data are based on geographic locations, not ownership of auto companies. For example, General Motors' production in the United States goes to "USA", while its production in China is counted under "China".

Auto sectors in other parts of the world didn't fare as well during the economic crisis. At the pre-recession level in 2005, North America and Western Europe each produced more than three times as many vehicles as China. Between 2005 and 2009, however, total U.S. production was halved to 5.7 million units; Canada also registered a net decline of over 1 million units. Even Mexican production, which appeared to be the most resilient among the North American carmakers, saw a slight decrease of over 100,000 units between 2005 and 2009. In 2010 and 2011, the United States auto sector started to recovery, finishing in 2011 as the second-largest auto producing country, behind China. For carmakers in Europe (after an increase in production between 2004 and 2007), overall production dropped by about 6 million units in 2009 from the 2007 level.⁷

Japan, formerly the largest motor vehicle producer, had shown relatively little overall growth in production before being affected by the global recession. This was, in part, because of a domestic economic slowdown that has lasted for nearly two decades, the strengthening of the yen, and increased production in overseas manufacturing plants. Its total output has stagnated at around 10 million vehicles per year between 2000 and 2003. Strengthening exports, including to China and the United States, led to an increase to about 11.6 million units of production each in 2007 and 2008. In 2009, hit by global economic crisis, Japan's auto production dropped to below 8 million units. Production level slowly recovered in 2010, and then dropped again in 2011 to below 8 million units, in part because of the severe earthquake and tsunami that hit northern Japan in March 2011, which had an immediate impact on the auto industry.

⁷ *Ward's Automotive Yearbook 2009*, p. 5. One notable trend is that, starting around 2002, vehicle production in Western Europe has been flat or declining, albeit at a moderate rate. However, output in eastern and central Europe has been rising steadily—between 2004 and 2008, total vehicle production in eastern and central Europe doubled to over 6.5 million units (despite a dip in 2009, largely due to the collapse of the market in Russia).

Figure 2. BRIC Countries Motor Vehicle Production
(Annual Vehicle Production, 2000-2011)



Source: Automotive News, *Market Data Book*, 2002, and *Global Market Data Book*: 2004, 2005, 2007, 2008; *Ward's Automotive Yearbook*, 2009-2011; IHS Automotive, 2011 *Global Vehicle Production*; Chinese MITT, 2011 *Auto Sector Summary* (Jan 19, 2012).

Among the developing nations, China's increase in output has also placed it far ahead of other countries that are considered as actual or potential major automotive producers. In the so-called BRIC countries (Brazil, Russia, India, and China), which showcase emerging economies, there has been considerable growth in automotive production (see **Figure 2**). However, the combined net growth of vehicle production in these other three BRIC countries between 2000 and 2011 was only slightly over a quarter of the total volume growth in China.

Changing Composition of Production

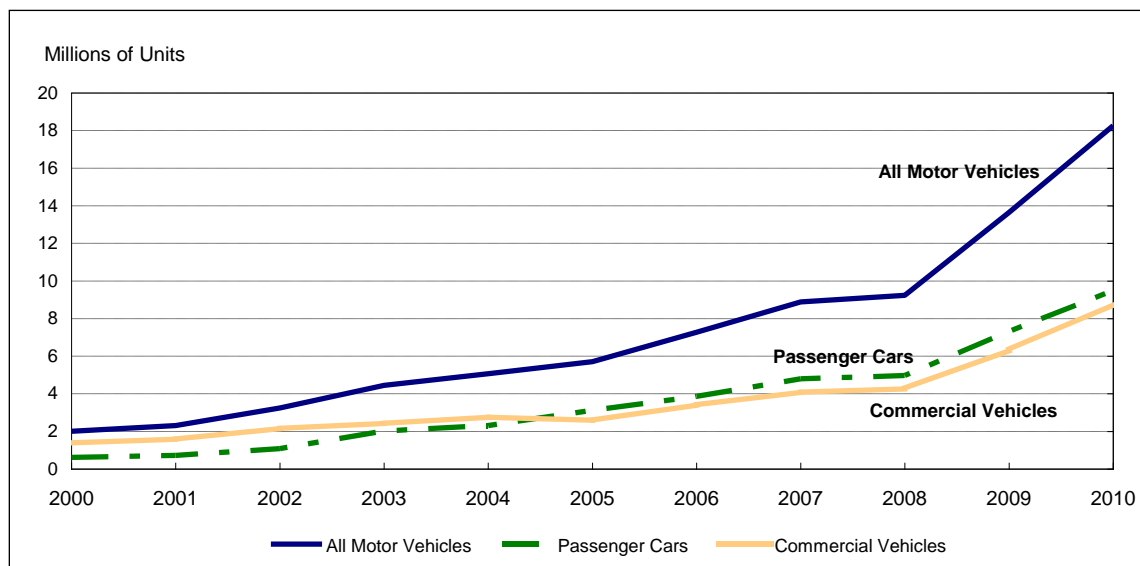
Along with the volume of vehicles, product composition of Chinese motor vehicle output is also changing toward meeting growing domestic consumer demand for personal vehicles, notably passenger cars. This is closer to the model of production seen in a mature industrial market than in a developing economy. It is also an indication that, as per capita income grows rapidly, especially in the coastal regions and big inland cities, personal vehicles are no longer seen as luxury items exclusively for the privileged few.

In the mid-1990s, out of a total annual output of 1.2 million vehicles, China produced 300,000 passenger cars, with trucks and buses accounting for the majority of the output. The United States in the 1990s also produced more trucks than passenger cars. But in the U.S. case, trucks overwhelmingly consisted of minivans, SUVs, and pickup trucks, which were generally considered being more for personal use. In China, however, the "truck" category in the 1990s was much more oriented toward heavy duty and mass transit equipment, while the "bus" category appears to include at least some types of minivans. As late as 2004, combined truck and bus production in China was still slightly higher than output of passenger cars.⁸

⁸ Chinese data for the "truck" category combines "light" trucks and heavy trucks, while the "bus" category appears to

Although there are differences in vehicle categorization, a key indicator for China's auto industry is the rise of the share of production devoted to passenger cars. **Figure 3** shows that production of passenger cars started to rise consistently after 2000.

Figure 3. Chinese Motor Vehicle Production
(Annual Vehicle Production, 2000-2010)



Source: Ward's Automotive Yearbook, 2001-20011.

Notes: Commercial Vehicles include trucks and buses, a category that includes light trucks, SUVs, and minivans.

Prior to 2000, China's leading automakers were joint-venture partners with foreign automobile companies, with product mix and output subject to bureaucratic intervention and negotiations—a process well documented in the book *Beijing Jeep*.⁹ But this began to change, as noted in Ward's 2001 Automotive Yearbook:

In years past, the Chinese government would decide what product would best suit a proposed automotive joint venture, usually a 50/50 partnership between a global automaker and a state-run Chinese firm. Although the products often were ill-suited to market conditions, multinational automakers agreed to build them in order to get a foothold in the potentially high-volume Chinese market.... In 2000, China granted the wishes of many global automakers, allowing them to build small, affordable vehicles—known as “people’s cars”—for the domestic market.

The liberalization of product regulations undoubtedly positioned China for long-term growth in the private car ownership market. The country's pending entry into the World Trade Organization (WTO) was expected to open the market even further for private

include at least some types of minivans, which, in the United States, are considered “light” trucks. Production and sales data for the United States typically combine cars and light trucks to yield total vehicle sales. During most of this decade, light truck production and sales in the U.S. were greater than that for passenger cars. Because Chinese data do not distinguish between heavy truck and light trucks, the key variable would appear to be the share of production devoted to passenger cars.

⁹ Jim Mann, *Beijing Jeep: A Case Study of Western Business in China* (Boulder, CO: Westview Press, 1977 ed.).

consumers and ensure a big pay-off for companies waiting to tap China's boundless potential.¹⁰

China's passenger car output increased slowly from a quarter of total motor vehicle production in 1994 (not shown in **Figure 3**) to about 30% in 2000-2001. After that, passenger car output drove rapid motor vehicle production growth. As overall output increased from an annual range of 600,000 to 700,000 vehicles to over 5 million annually by 2004, nearly 50% of total production was passenger cars by that year (see **Figure 3**). Starting in 2005, more passenger cars have been produced in China than commercial vehicles, roughly at a 55/45 split.

The World's Biggest Auto Market

China's motor vehicle market has grown at an unprecedented rate in recent years, with new vehicle production and sales in lockstep growth. The first wave of car buyers appeared in China's large cities along the prosperous eastern seaboard, where vehicle ownership surged around 2000. Five years later, the car market took off in the smaller coastal urban areas and major inland cities.

The growth in vehicle sales in China slowed in 2008, reflecting the weakened state of the domestic economy and low consumer confidence amid a global economic downturn. In response, the Chinese government introduced several policy measures (as part of the aforementioned economic stimulus) to boost car sales, including a number of subsidies to consumers, lower purchase taxes, and expansion of bank credit to encourage lending (see **Text Box**). These incentives, which were initially scheduled to expire at the end of 2009, were extended to 2010 and further propelled vehicle sales to over 18 million units in 2010.¹¹

Incentives for Vehicle Purchases

In November 2008, the Chinese government introduced a fiscal stimulus package worth Rmb 4 trillion yuan (\$586bn), to spur domestic demand and avert an economic slowdown. In 2009 and 2010, the government offered incentives to promote vehicle sales in China, including a sales tax cut on smaller cars and incentives to encourage vehicle purchases in rural areas. Sales tax on cars with engines of 1.6 liters or less was halved to 5% in 2009, and then raised to 7.5% in 2010. This preferential rate expired at the end of 2010.

China also launched an 18-month cash-for-clunker program in June 2009, offering subsidies to vehicle owners who purchased new vehicles to replace older models. These incentives were further increased in 2010, ranging from Rmb 5,000 to 18,000 yuan (\$735 to \$2,647, at 6.8 yuan/dollar), depending on vehicle category and engine size.

A number of factors are likely to drive market demand in the next few years:

- Market potential arises from China's relatively low rate of car ownership, which stood at about 30 cars per 1,000 people. This ratio is low compared with a global average of 120 per 1,000 and 700 to 800 per 1,000 in the United States.¹² China's rapid economic growth and rising personal income, particularly in big cities, will likely continue to fuel the demand for personal motor vehicles.

¹⁰ *Ward's Automotive Yearbook 2001*, p. 72. China joined the WTO in 2001, upon which automotive import tariffs were cut to a rate of 25% on imported vehicles and 10-14% on auto parts in 2006.

¹¹ *Ward's Automotive Yearbook 2011*, p. 5. Auto sales in China in 2009 reached 13.6 million units, making China the world's largest auto market for the first time: vehicle sales in Tier-1 cities increased by 46% from 2008, while sales in smaller cities grew more than 60%.

¹² *Economist Intelligence Unit*, "Industry Report: Automotive, July 2009"; *Financial Time*, "Chinese aim to be king of the road," April 22, 2010.

- Since 2002, both foreign and domestic carmakers have expanded production capacity in China in anticipation of continued strong demand growth. This has generated significant competition and made vehicles more affordable. For example, average car prices across China in 2007 dropped by nearly 6% from 2006, while the per capita income of urban residents increased by 12.2%, to \$1,942.¹³ With more products available at competitive prices, car ownership could continue to expand rapidly among the expanding middle-class.
- Another factor resulting in greater demand for cars is the improvement and expansion of China's road network. China has been investing heavily in improving its highway network. According to an industry report, by the end of 2010, China had about 74,000 kilometers (km, approximately 45,982 miles) of high-speed roads (expressway), making it one of the largest motorway systems in the world. Most of China's road network was built within the past two decades.¹⁴

Growing Pains

Fearing its economy could suffer a downturn in the face of decreasing exports, the Chinese government enacted an extensive economic stimulus program, which became a major force that drove the surge in vehicle sales, from an annual growth rate of 6.7% in 2008, to 46% and 32% in 2009 and 2010, respectively.¹⁵

The rapid expansion of the Chinese auto market not only was a boost to auto makers but also may have led to overcapacity. An official of industrial coordination at China's National Development and Reform Commission reportedly cautioned, "China's automobile production capacity, based on a recent tally of 30 automobile groups, will far exceed the planned 31.24 million by 2015."¹⁶

Rapid increase in the number of vehicles on the road has already put China's road network and traffic system to test, causing severe traffic congestion and air pollution, especially in major cities such as Shanghai and Beijing. In August of 2010, China recorded what is described as its worst traffic jam in history, when road work and a high volume of commercial vehicles clogged a highway north of Beijing for over 10 days, stretching as long as 100 kilometers (approximately 62.14 miles) at one point.¹⁷

Parking has become another major headache for drivers in big Chinese cities. Since many residential communities were built before the boom in car ownership, parking spots are scarce. The construction of public parking lots as well as roadside parking spots has not kept up with the growth of cars on the road. It is reported that the number of cars in Beijing has more than doubled within the last decade to 5 million, but there are only an estimated 740,000 spaces for parking.¹⁸

¹³ *Automotive News*, "2008 Guide to China's Auto Market," April 14, 2008, p. 3.

¹⁴ *Ibid.*; *Financial Times*, "Rule of the Iron Rooster," August 24, 2009; *Research in China*, "China Road Construction Industry Report, 2010," March 2011; <http://www.researchinchina.com/Htmls/Report/2011/6053.html>, as viewed on February 28, 2012.

¹⁵ *Automotive News China*, "Auto sales subsidies for China's rural residents to end," January 4, 2011; *The Wall Street Journal*, "Auto buyers in China tap brakes," October 14, 2011.

¹⁶ *Ward's Automotive Yearbook 2011*, p. 6.

¹⁷ *The Wall Street Journal*, "Beijing cracks down on car buyers," December 24, 2010; *Financial Times*, "Drive to keep the industry moving," February 27, 2012.

¹⁸ *The Economist*, "No parking: a dearth of parking places riles the new middle class," March 24, 2012.

In 2011, some municipal governments, including Beijing, moved to limit new vehicle registrations in order to ease traffic congestion. Shanghai, the country's wealthiest metropolis, began auctioning license plates as early as 1994. About 8,000 to 9,000 license plates are auctioned monthly, according to a *Wall Street Journal* report, at an average price of \$6,000 or more. In March 2012, one weekly average bid for a new Shanghai license plate reached \$9,380. The city of Shanghai also bans vehicles with non-Shanghai plates from highways at rush hour.¹⁹

Shanghai's measures reportedly have produced intended results—traffic in Shanghai moves better than in Beijing. However, the auction process lacks transparency and leaves car buyers frustrated. After license plates are auctioned off, it is not uncommon to find them sold or traded in the black market.²⁰

Foreign and Domestic Auto Producers in China

American automotive manufacturers were among the earliest international companies to move into China with the opening of the market to foreign investors in the 1980s. In 1983, after tedious and difficult negotiations, American Motors Corporation (AMC) signed a joint-venture (JV) agreement with China's Beijing Automotive Works, the first such major manufacturing deal reached by a Western industrial company in China. Despite this early initiative, American companies largely lost out in the early period of growth in the Chinese automotive market, first to Japanese imports, and then to European investors, particularly VW.²¹

Independent Production vs. Foreign Cooperation

When the central government decided to open China's auto market to international companies, it understood that its domestic manufacturers would not be able to compete with the more sophisticated and experienced foreign rivals. To surmount this problem, foreign automakers were allowed to enter the Chinese market only through joint ventures with local partners, oftentimes state-owned companies (SOEs), each no more than 50% controlled by a major foreign nameplate automotive manufacturer. For example, VW has joined forces with Shanghai Automotive Industry Corp. (SAIC) and First Automotive Works Corp. (FAW). SAIC is also a joint venture partner of GM, while FAW is also a partner of Toyota. Honda and PSA Peugeot Citroen have both formed partnerships with Dongfeng Motor Corp. There are numerous other automotive manufacturing alliances between domestic and foreign automakers.

Foreign investments entered China in three waves. Between the mid-1980s and late 1990s, China's market was dominated by three foreign joint ventures—VW's joint venture, with SAIC, and with FAW, and PSA Peugeot Citroen's joint venture with Dongfeng.²² From the late 1990s to 2001, GM and Honda entered the market, and then, after China's accession to the World Trade Organization (WTO) in 2001, so did other foreign automakers.²³

¹⁹ *The Wall Street Journal*, "Beijing cracks down on car buyers," December 24, 2010; *Global Times*, "Shanghai's Car Plate Auction Hits New High," March 19, 2012.

²⁰ *Shanghai Daily*, "Auctioning License Plates Far Better than Dodgy Lottery," May 4, 2011.

²¹ Mann, *Beijing Jeep*, especially chapters 2, 4, 11, 24 and epilogue.

²² PSA Peugeot-Citroen was among the first foreign automakers to set up operations in China when it opened a joint venture with Guangzhou Auto Group in 1985. But this venture failed, and Peugeot sold its stake to Honda Motor in 1997. It then folded Peugeot production into the Dongfeng joint venture in 1994 and started to produce Citroens.

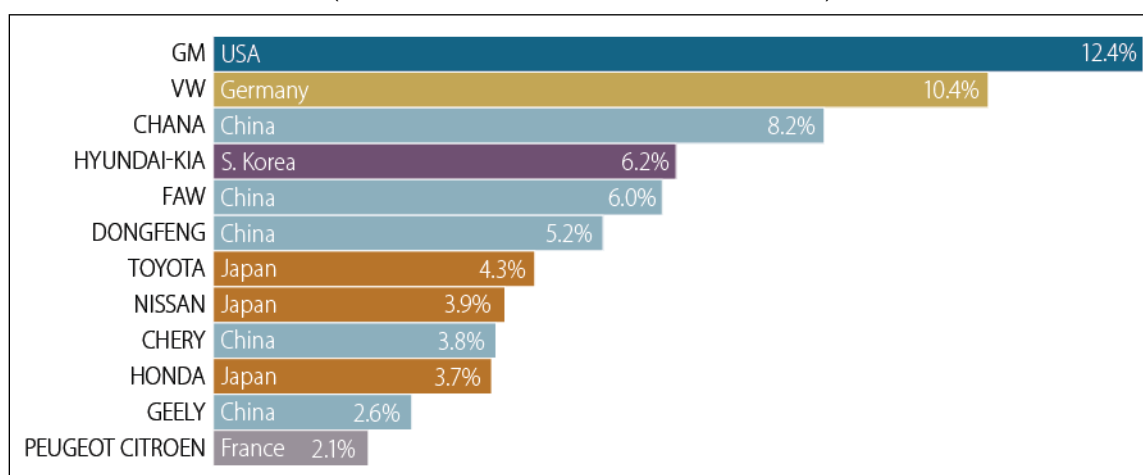
²³ *Economist Intelligence Unit*, "Automotive Briefings & Forecast: Foreign investment in car making," January 31, 2008.

The Chinese government hoped, initially, that such arrangements would allow Chinese car producers to tap the technological and management expertise of their foreign partners. In exchange, foreign automakers would gain access to the vast Chinese market. Nearly three decades later, however, foreign corporations are perceived by the domestic automakers to have benefited more than their local partners from these link-ups. According to *Automotive News China*, “while some [domestic] brand cars are built on platforms transferred from global automakers, almost all of the rest are products of the reverse engineering of international models. Some domestic firms continue to resort to outright copying.”²⁴

The automotive market in China today is largely dominated by international companies (see **Figure 4**). Such dominance is particularly strong in the fastest-growing passenger cars category, where about two-thirds of new cars sold were produced by international companies. GM and VW are by far the leading vendors, each commanding 12.4% and 10.4%, respectively, of the Chinese market, which is also their biggest market (in terms of number of cars sold) in their respective global portfolio. A number of other major car makers follow, including Toyota, Honda, Nissan of Japan, and Hyundai-Kia of South Korea.

Among the domestic automakers, Chana, FAW, and Dongfeng were the leading domestic manufacturers in sales in 2010. However, trucks and buses counted for a significant share of total vehicles—FAW and Dongfeng predominantly make commercial vehicles; about 60% of Chana vehicles were trucks and buses, not passenger cars. Major Chinese passenger car makers are Chery, Geely, SAIC, and BYD.

Figure 4. Major Vehicle Manufacturers in China
(Market Share of Vehicles Sold in China, 2010)



Source: Ward's Auto InfoBank.

Note: Units of vehicles produced and sold under respective automakers' nameplates. Foreign automakers are required to form joint ventures and co-produce vehicles with Chinese partners. The listed producers each command at least 2% of the Chinese auto market.

Recently, the Chinese government has moved to remove some incentives for foreign investment in the auto sector and to promote indigenous brands. These government policies and measures will be discussed later in this report.

²⁴ *Automotive News China*, “Letting BAIC bid for Opel reflects a major government policy shift,” July 8, 2009; also see cases discussed in a later section “Chinese Auto Sector Commitments.”

Foreign Auto Makers

To virtually all of the major global automakers, China is the biggest and the fastest-growing market. Given such prospects, almost all the major international automakers either have been expanding operations in the country or are in the process of establishing plants in recent years. For example, VW, through two joint ventures with Chinese partners SAIC and FAW, has nine auto plants operating in China and three more under construction.²⁵ In August 2009, GM formed a new 50-50 joint venture with FAW Group to make light trucks in China for the first time. In early 2012, Shanghai GM, reportedly, has received government approval to build its fourth plant in central China.²⁶

General Motors (GM)

Despite AMC's early entry, and Chrysler's subsequent purchase of AMC and its successful management of the Beijing Jeep factory, GM is the U.S. automotive manufacturer that has made the biggest investment and achieved the most success in the Chinese auto market. In 1997, GM established a 50-50 joint venture with the Shanghai Automotive Industry Corporation Group (SAIC) to manufacture passenger vehicles. GM also participates as a minority shareholder (44%) in a joint venture with both SAIC (50.1%) and Wuling Automotive Company (5.9%) to produce minivans, "mini-trucks," and passenger sedans.²⁷

In contrast to its experience in the challenging environment in North America during the economic crisis, GM expanded rapidly in China and sold more cars in China than in the United States in 2010 and 2011. The automaker, which sold its first car in China in the 1920s, sold 2.55 million vehicles in China in 2011, and expects to double annual vehicle sales in China to more than 5 million by 2015.²⁸

GM and its various joint-venture partners manufacture GM Buick, Cadillac, Chevrolet, Opel, and Wuling vehicles. Buick and Chevrolet are GM's volume brands in China. Many of these vehicles are based on designs by Daewoo or GM's European subsidiary, Opel. Vehicles are re-engineered for China at the Pan Asia Technical Automotive Center (PATAC), a GM joint venture with SAIC.²⁹ GM is building a two-phased advanced automotive technology center (GM ATC) in Shanghai, which will have 62 test labs and 9 research labs when completed. The first phase of the ATC, Advanced Materials Lab, was opened in September 2011 and is for research and development of battery cells and light weight automotive materials. The second phase is scheduled to open in late 2012.³⁰

²⁵ *Automotive News China*, "VW contracts to build 12th Chinese assembly plant," January 10, 2012. VW has a 50-50 joint venture with SAIC (Shanghai VW), which has five operating plants and two more under construction in Yizheng and Ningbo, respectively. VW's joint venture with FAW operates four plants and another is being built in Foshan.

²⁶ *Automotive News China*, "Shanghai GM to build plant in central China," February 14, 2012. Shanghai GM has plants in Shanghai, Yantai, and Shenyang. The fourth facility is to be built in Wuhan in Hubei province.

²⁷ GM China website, "About GM China"; <http://www.gmchina.com/aboutGM/gmInChina.asp>; GM Media "China" <http://media.gm.com/media/cn/en/gm/company.html>, as viewed on February 23, 2012.

²⁸ Bloomberg News, "GM lead U.S. carmaker gains in China as Honda Motor's deliveries decline," January 9, 2012.

²⁹ GM China website, <http://www.gmchina.com>, "GM Communications: General Motors Sets Company Sales Record in China in 2008," January 6, 2009.

³⁰ GM website, GM News, "GM China to finish advanced technical center in 2012," December 19, 2011; http://media.gm.com/media/us/en/gm/news.detail.html/content/Pages/news/us/en/2011/Dec/1219_china_tc.

As of 2012, GM had 11 joint ventures in China, a wholly owned parts distribution center, and a wholly owned investment subsidiary in Shanghai that houses GM's local staff and invests in GM's vehicle joint ventures in China. GM employs more than 35,000 employees in China.³¹ GM relocated its international operations from Detroit to Shanghai in 2009—GM International Operations (GMIO) replaces the regional operating structure that characterized GM's operations before bankruptcy. The new organization would have functional and geographic control of all GM international operations worldwide, with the exception of GM North America.³² As GM filed for bankruptcy in 2009 and went through the subsequent restructuring, it sold 1% of its stake in the joint venture to SAIC for \$84.5 million, giving SAIC majority control. However, GM holds an option to reacquire the 1% share and, after lengthy negotiation, received SAIC approval in May 2012. The deal, still pending Chinese government approval, would restore GM's ability to have equal authority on operational decisions.³³

Chrysler

Chrysler does not currently have a manufacturing presence in China. After Chrysler stopped producing Jeep models in China in 2007, it decided to import vehicles, mainly Jeep, to supply the Chinese market. In 2011, Chrysler sold 22,294 Jeeps in China. Tariffs and shipping costs add a substantial markup to these imported units and make it hard to compete in a market like China. It became crucial for Chrysler to produce vehicles locally.³⁴

When Chrysler was part of Daimler Chrysler (1998-2007), it was part of Daimler's joint venture with Beijing Automotive. Chrysler withdrew from that alliance in late 2008 and has so far not reached an agreement with another Chinese partner. A deal to produce cars with Chery Automotive failed to materialize in December 2008; another planned partnership to share technology, components, and distribution channels with Great Wall Motor was dropped in 2009.³⁵ Fiat SpA, the Italian automaker, took control of Chrysler after it emerged from U.S. government-sponsored bankruptcy in 2009. The Fiat-Chrysler group reportedly is exploring the possibility to form a joint venture with Guangzhou Automobile Group to produce Jeeps in China, for the Chinese market.³⁶

³¹ Ibid.

³² GM website, GM News, "General Motors Makes Leadership Appointments for New Shanghai-Based International Operations," July 24, 2009; <http://media.gm.com/servlet/GatewayServlet?target=http://image.emerald.gm.com/gmnews/viewmonthlyreleasedetail.do?domain=797&docid=55835>.

³³ *The Wall Street Journal*, "GM, SAIC near deal to adjust partnership," January 11, 2012; Bloomberg, "SAIC Board Approved Transfer of 1% Venture Equity to GM," May 25, 2012. According to an April 2012 statement, Shanghai GM would be split into two units: operations and sales. Both partners would hold equal stakes in the operations unit, while SAIC would have 51% majority stake in the sales arm so that it could book the venture's revenue in its financial statement.

³⁴ *Automotive News China*, "How Jeep can make a comeback in China," February 21, 2012.

³⁵ *The Wall Street Journal*, "Chrysler and Chery End Small-Car Project," December 10, 2008; *Motor Authority*, "Chrysler ends talk with China's Great Wall Motors," May 17, 2009.

³⁶ *The Detroit News*, "Fiat-Chrysler in talks to produce Jeeps in China," January 26, 2012. Fiat has formed a joint-venture with Guangzhou, Guangqi Fiat, which is scheduled to start production in July 2012. Guangzhou has joint ventures with other foreign automakers, including Honda Motor Co. and Peugeot SA.

Ford

Among the Detroit-based producers, Ford has been slowest to establish a manufacturing presence in China. According to Ford China's corporate website, Ford started to produce and sell trucks and vans through its commercial vehicle joint venture with Jiangling Motors, Corp. in 1997. Ford entered passenger cars segment in 2003, through a three-way joint venture with Chongqing Changan of China and Mazda of Japan.³⁷ After a strong sales increase from 2005 to 2006, Ford sales have been relatively flat in this rapidly growing market. Ford's total sales in 2011 of affiliated brands were 519,390 units, nearly one-fifth of GM's sales in China.³⁸ In February 2012, Ford opened its third assembly plant in Chongqing, as part of its expansion plan.³⁹ In April 2012, Ford announced that it would build a \$760 million assembly plant in Hangzhou. Ford plans to have an annual capacity of 1.2 million cars by 2015.⁴⁰

However, like other global carmakers, American auto companies may face regulatory hurdles that could complicate planning for future growth. The Chinese government, at the beginning of 2012, announced its decision to stop encouraging foreign investment in auto manufacturing, except for new-energy vehicle such as electric vehicles. The government has shifted its policies to support the growth of domestic auto makers and promote domestic brands. Industry analysts caution that proposals for new alliances and capacity expansion, which is crucial to Ford and Chrysler, could face a slower approval process, among other hurdles.⁴¹ China's policy shift and the implications for global auto companies are discussed later in this report.

Chinese Auto Assemblers and Parts Makers

The Chinese automotive market remains highly fragmented. There are about 100 vehicle manufacturers, with only a few capable of achieving sales volumes of significance.⁴² Many are subsidized by provincial governments eager for the prestige, employment, and tax revenue provided by the automakers. About two-thirds of the top 25 domestic producers are owned by the state.⁴³ The central government has been encouraging industry consolidation, but has had little success so far. Part of the reason is the vested interest of local governments.⁴⁴

On the automotive suppliers' side, a diversity of other strategies have been adopted by Chinese parts producers, including direct relationships with foreign automotive suppliers. With no government restrictions on joint venture ownership rules, such as those that affect nameplate vehicle assembly operations, more and more international parts manufacturers have followed their original equipment manufacturers (OEM) partners to China and established operations there. For example, as of March 2012, Magna International Inc., Canada's largest auto parts maker, has

³⁷ *Automotive News China*, "Ex-U.S. China ambassador to China joins Ford board," February 10, 2012. Ford and Mazda have been seeking to dissolve the three-way partnership and then form new two-party joint venture with Changan, pending approval from the Chinese authorities. Ford's appointment of Jon Huntsman, a former U.S. ambassador to China, to its board of directors, may assist Ford in the Chinese market, including reorganizing this three-way partnership.

³⁸ *Ibid.*

³⁹ *Automotive News China*, "Ford Opens 3rd China Auto Plant, Boosting Capacity by a Third," February 24, 2012.

⁴⁰ *The New York Times*, "Ford to Build Plant in China to Bolster Global Sales," April 19, 2012.

⁴¹ *The Wall Street Journal*, "Ford Faces Growth Hurdles in China," February 27, 2012.

⁴² *Economist Intelligence Unit*, "Industry Report: Automotive July 2009."

⁴³ *Automotive News*, "2009 Guide to China's Auto Market," April 27, 2009, p.20.

⁴⁴ *Economist Intelligence Unit*, "Industry Report: Automotive July 2009."

20 manufacturing and 10 sales, engineering, and product development facilities in China; Visteon, an American company, has 25 manufacturing facilities and 3 customer service centers in China.⁴⁵

Another option for Chinese OEMs and OEM suppliers is outright purchase of foreign automotive suppliers. This strategy has the advantage of allowing Chinese firms to target technologies and intellectual property that they need to improve automotive quality. For example:

- In June 2009, Geely Automotive, a private domestic manufacturer of passenger vehicles, completed the acquisition of an Australian auto parts company, Drivetrain Systems International (DSI), which will allow Geely to improve its development of gearboxes.⁴⁶
- In 2009, BeijingWest Industries (BWI), a joint venture of the investment arms of Chinese state enterprises, Beijing-based Shougang Corp. and the Fangshan District government of Beijing, acquired the suspension and brake units of Delphi Corp., the U.S.-based auto parts supplier. BWI has operations in Ohio and Michigan and makes components for a number of vehicles, such as Chevrolet Corvette and Audi TT.⁴⁷
- In 2010, China's Pacific Motors, controlled by Aviation Industry Co. of China (AVIC), a state-owned enterprise (SOE), and Beijing E-town International Investment Co. bought a U.S. automotive parts company, Nexteer Automotive, from GM. Nexteer has operations in several countries. The Nexteer plant in Saginaw, MI, is being retooled to build electronic-steering systems to supply GM pickups and SUVs.

With Western automakers facing declines in production and sales, especially in 2009 and 2010, speculation arose that Chinese companies might seek to acquire some of the assets of troubled Western car makers. While many remain concerned over Chinese firms investing in the United States, especially those owned or controlled by the government, Chinese companies are making direct industrial investments in the United States and are "scouring the Midwest for more automotive deals," as described in a *Wall Street Journal* report.⁴⁸

Outward Investment: Major Acquisitions and Consolidations

One strategy the Chinese government has been exploring is whether to allow domestic automakers to acquire foreign brands. Opportunities to purchase distressed foreign assets came during/following the 1997-1998 Asian financial crisis and then the global economic slowdown in 2008-2009.

⁴⁵ Magna corporate website (<http://www.magna.com/magna/en/global/>); Visteon website (<http://www.visteon.com/worldwide/asia/china.html>), both as viewed on March 21, 2012.

⁴⁶ *Economist Intelligence Unit*, "Industry Report: Automotive July 2009"; and Geely corporate website (www.geely.com).

⁴⁷ [www.china.org.cn](http://www.china.org.cn/business/2010-06/22/content_20318307.htm), http://www.china.org.cn/business/2010-06/22/content_20318307.htm; "BWI Boosted by Delphi Acquisition," June 22, 2010; *Automotive News China*, "Beijing Has Come to Detroit's Backyard," December 27, 2011.

⁴⁸ *The Wall Street Journal*, "In the Heart of the Rust Belt, Chinese Funds Provide the Grease," February 11, 2012.

SAIC Acquires Rover Group

An early attempt of this kind was the purchase of MG Rover by SAIC and Nanjing Automobile Group in 2005.⁴⁹ Seeking to obtain advanced automotive technology and manufacturing capacity, these two Chinese automakers set out to acquire MG Rover, a company with a complicated and sometimes unsuccessful history.

The predecessor of MG Rover was the Rover Group, itself a remnant of the nationalized British Leyland Motor Corporation (later known as BL Ltd.). BL manufactured such brands as Jaguar, Rover, Land Rover, and Mini. In 1984, Jaguar was privatized and later sold to Ford in 1989 and then to Tata Motors of India in 2008. In 1986, BL was renamed Rover Group and, in 1988, was privatized and sold to British Aerospace. BL's commercial truck and bus business was spun off in 1986. The remainder of Rover Group was purchased by BMW in 1994. That purchase reflected BMW's effort to become a volume car producer. By 2000, Rover Group was inflicting a serious financial drain on BMW, which sold the MG and Rover brands to a group of British investors, the Phoenix Consortium, for £10. At the same time, BMW also sold the Land Rover brand to Ford,⁵⁰ while retaining Rolls-Royce,⁵¹ the Mini brand, and production facilities at Cowley and Swindon, England. BMW also kept the Triumph and Riley trademarks.

The Phoenix Consortium, which formed MG Rover, also acquired the Longbridge assembly plant in Birmingham, England. MG Rover went into receivership in 2005. In July 2005, Nanjing Automobile Group purchased the remaining assets of MG Rover for about \$100 million and invested another \$50 million to prepare the plant for production. Also in 2005, before MG Rover collapsed, SAIC acquired the intellectual property rights to two Rover automobile platforms and planned to produce vehicles in China for domestic and export sales. On Rover platforms, SAIC has developed cars now sold in China under brand names Roewe and MG Mingjue.⁵²

In December 2007, SAIC, China's largest automaker, acquired Nanjing Automobile.⁵³ Chinese government officials, reportedly, have said they want to see an industry centered on three or four auto groups that have the resources and technology to succeed globally. The tie-up between SAIC and Nanjing Auto could serve as a model as regulators push smaller auto makers to merge with larger manufacturers.⁵⁴

In September 2008, the Longbridge plant, which employed about 380 workers, began assembling MG roadster kits imported from China.⁵⁵ In 2011, SAIC started to sell a four-door sedan, the MG6 in the UK. The MG6, reportedly, is 80% built in China and shipped to the UK for final assembly. SAIC is hoping to increase annual car production at its UK facility from the previous total of hundreds to thousands.⁵⁶

⁴⁹ In 2004, SAIC bought roughly half of South Korea's Ssangyong Motor Co. for \$500 million but sold the stake in 2010 after Ssangyong's business plunged in the wake of the 2008 global financial crisis.

⁵⁰ Ford sold Land Rover (along with Jaguar) to Tata Motors in 2008.

⁵¹ The automobile brand, not the aerospace company.

⁵² *Automotive News*, "SAIC Plans Car for China and Export," April 13, 2006; *Financial Times*, "Nanjing Auto Signs Lease on Longbridge Plant," Feb. 21, 2006, and "Shanghai Automotive to make Rover-Based Cars in China," February 24, 2006.

⁵³ *Automotive News*, "China's SAIC Takes Over MG Plant in England," December 26, 2007.

⁵⁴ Reuters, "China's SAIC Motor, Nanjing Auto Announce Merger," December 26, 2007; *Automotive News China*, "Letting BAIC bid for Opel Reflects a Major Government Policy Shift," July 8, 2009.

⁵⁵ *Automotive News Europe*, "MG Name Stands Proud Again at Longbridge," January 21, 2009.

⁵⁶ *The Wall Street Journal*, "Homecoming is Set for MG," March 16, 2011; *Birmingham Post*, "Longbridge-made MG6

Geely Buys Volvo

In August 2010, China's largest privately owned automaker, Zhejiang Geely Automobile Holdings Group (Geely), completed acquisition of Volvo from the Ford Motor Company. Geely paid \$1.8 billion, a fraction of the \$6.45 billion that Ford paid for Volvo in 1999.⁵⁷ Geely reportedly plans to retain the Volvo management, headquarters, and manufacturing facilities in Sweden and Belgium; Ford will continue to supply components to Volvo for an unspecified period of time. Ford's China joint venture, Changan Ford Mazda Automobile Co., still produces the Volvo S40 and S80 under a contract with Volvo.⁵⁸

Despite Geely's acquisition of Volvo, the central government still sees Volvo as a foreign entity, according to a February 2012 report by *Automotive News China*. To follow China's investment rules, Volvo will establish a 50-50 joint venture with its Chinese parent company, Geely, to get government approval to produce cars in China. Volvo will also follow China's requirement that foreign automakers help Chinese partners develop indigenous brand of cars and develop electric cars.⁵⁹

In March 2012, Geely and Volvo signed a technology transfer agreement, under which the two automakers would discuss specific ways Geely can tap technology that Volvo plans to phase out over the next several years. This could help Geely, the Chinese maker of low-cost cars, to enrich its product portfolio and become more competitive in its home market.⁶⁰ However, in addition to the risks of brand dilution for Volvo, questions remain about whether Chinese auto companies like Geely would be able to build upon acquired technology, come up with its own design, and eventually move up the manufacturing value chain as world-class car maker.

Hummer Deal Falls Apart

In 2009 a privately owned heavy equipment manufacturer, Sichuan Tengzhong Heavy Industrial Machinery, agreed to buy the Hummer sports utility vehicle marque from GM. However, the deal failed to receive approval from Chinese regulators and eventually fell apart.⁶¹

Although specific explanations for the failure of acquisition were not released, it was speculated that the proposed acquisition of a so-called gas-guzzling brand like Hummer was not in line with the government's aim to promote vehicle fuel efficiency and control emissions. In addition, the central government has long advocated industry consolidation and would like to streamline a sprawling domestic auto industry that has expanded to include over 100 car producers. The

Hits Sales of £3M in First Two Weeks," June 3, 2011.

⁵⁷ *The Economist*, "Devolving Volvo," March 28, 2010.

⁵⁸ *The Telegraph*, "Geely Completes Acquisition of Volvo," August 3, 2010; *The Wall Street Journal*, "Geely Sets Second Volvo China Plant," June 24, 2011.

⁵⁹ *Automotive News China*, "Volvo to Establish Joint Venture with Geely, Aims to Produce Vecles in China," February 24, 2012.

⁶⁰ *Automotive News*, "Geely Signs Technology Transfer Deal with Volvo," March 9, 2012; Reuters, "China's Geely Hopes go Get Volvo JV Approval in H1," March 22, 2012; Reuters, "Volvo Technology Transfer a Lifeline for Geely," April 21, 2012.

⁶¹ General Motors Company, news release, "General Motors and Tengzhong Sign Definitive Agreement for Sale of HUMMER," October 09, 2009; http://media.gm.com/content/media/us/en/news/news_detail.html/content/Pages/news/us/en/2009/1009_HUMMER_Sale; China Daily, "Tengzhong Withdraws Proposed Acquisition of Hummer," February 25, 2011.

Hummer deal by Tengzhong, a private company whose specialty is producing heavy vehicles and construction equipment (not automobiles), would have only contributed to the diffusion.⁶²

Chinese-Japanese Group Acquires Saab

In July 2009, Beijing Auto bid for Opel, a part of GM's European operations, but was turned down by GM after intellectual property issues became a hurdle.⁶³ Another issue was that Beijing Auto's parent company, Beijing Automotive Industry Holdings Co. Ltd. (BAIC), planned to move Opel production to China.⁶⁴

In early 2010, after GM had gone through restructuring, it sold Saab to Spyker Cars NV, a Dutch boutique sports car maker, which then renamed itself Swedish Automotive NV. However, Saab remained vulnerable because of its small size, little access to credit, and dependence on others for key technology, especially at a time when the global auto industry was undergoing restructuring and a slow recovery. A series of proposed investments during the summer of 2011 failed to materialize, including proposed investment cash flows from a few Chinese firms.⁶⁵

In September 2011, Saab filed for bankruptcy protection, under which it failed to reorganize afterwards. In December 2011, Saab filed for bankruptcy again and entered receivership, setting the stage for liquidation. The filing, reportedly, was triggered after its former owner, GM, had objected to deals with potential Chinese investors. GM stated its concerns that the key technology it had licensed to Saab would be transferred to China and could hurt GM's business there.⁶⁶

In June 2012, a Chinese-Japanese investment group agreed to buy Saab at an undisclosed price and convert the bankrupt automaker into a maker of electric cars. The purchasing group consists of Hong Kong-based renewable-energy power plant builder National Modern Energy Holdings Ltd., which owns 51%, and the Japanese investment firm, Sun Investment.⁶⁷

China's Recent Auto Sector Policies and Measures

The United States and other producers had been highly critical of China's *1994 Industrial Policy for the Automotive Sector*. This policy was replaced by a new one issued by the government in May 2004, with provisions discouraging the importation of auto parts and encouraging the use of domestic technology to be discussed later in this report.

In March 2009, the State Council, the highest executive organ of the central government, released the *Automotive Readjustment and Revitalization Plan* (the Plan), an industry-specific development blueprint for the auto sector in China, aiming to boost the Chinese auto sector amid the global economic slowdown.

⁶² *Time*, "A Deal Sours, and the Hummer Bites the Dust," February 25, 2010.

⁶³ *Automotive News*, "Geely, Magna Held Talks Over Opel, Reuters Reports," September 17, 2009.

⁶⁴ *Automotive News*, "Chinese Face Doubts in Bids for GM, Ford Discards," September 14, 2009.

⁶⁵ *The Wall Street Journal*, "Saab Auto Will Restructure," September 8, 2011; *Financial Times*, "Saab Files for Bankruptcy as Fundraising is Blocked," December 20, 2011; *The Wall Street Journal*, "Saab Automobile, 1950-2011," December 20, 2011. These Chinese firms include Hawtai Motor Group, Zhejiang Youngman Lotus Automobile Co. (Zhejiang Youngman), and Pang Da Automobile Trade Co., a Chinese auto dealership network.

⁶⁶ *Ibid.*

⁶⁷ Bloomberg.com, "Saab Auto Sold to China-Japan Group in Electric-Car Push," June 13, 2012. Zhejiang Youngman had been in talks since February 2012 and made a revised bid of more than 4 billion Swedish kronor (\$567 million) in June 2012.

Automotive Readjustment and Revitalization Plan (2009)⁶⁸

This three-year plan contains eight development goals for the auto industry from 2009 through 2011, all of which appear to be designed to ensure that automobile production and sales in China continue at a steady pace. These eight goals are summarized below:

- Achieve a 10% average annual growth rate, based on the more than 10 million vehicles to be produced and sold in 2009;
- Increase auto consumption with a reasonable system of taxes and fees, and to create an infrastructure to support electric vehicles;
- Optimize the auto market demand structure so that small passenger cars with engine displacement of under 1.5 liters are to account for more than 40% of the market, while cars under 1.1 liters will comprise over 15% of the market and heavy trucks will account for 25% or more;
- Make progress on industry consolidation and restructuring, aiming to consolidate the current 14 major auto manufacturing groups, which command more than 90% of market share, into 10 such groups; to form 2 to 3 large auto groups with an annual capacity of over 2 million units, and 4 to 5 smaller groups with annual production capacity of over 1 million units;
- Increase the market share of Chinese brand vehicles to at least 40%, with about 10% of vehicle exports made by independent Chinese automakers;
- Increase production capacity of new-energy vehicles to 500,000 units, whose sales volume should account for 5% of total passenger cars;
- Improve automotive research and development to meet international standards;
- Expand capacity of auto parts manufacturing through mergers and restructuring, while seeking technological independence in key auto parts and systems such as engine transmission, steering, braking, drivetrain, suspension, and vehicle control.

The plan also called for the overall improvement in automotive technologies, including greater fuel efficiency, development of new energy sources, and safety features. Intended to make the Chinese auto industry more competitive, these measures appear to be in line with the government's ongoing efforts to curb growing energy dependence on imported oil and to reduce air pollution, which, in China's biggest cities, is largely caused by cars. Gasoline consumption by motor vehicles accounts for about one-third of China's total oil demand. The government has introduced a number of measures to reduce fuel consumption, including raising fuel prices and reducing taxes on smaller vehicles,⁶⁹ and a pilot program launched in early 2008 offering incentives to taxi and other fleet operators if they purchase alternative-energy vehicles.⁷⁰

⁶⁸ *China Automotive Review*, "Automotive revitalization plan requires 10 percent growth in next three years," April 28, 2009, <http://www.chinaautomotivereview.com/pub/CARArticle.aspx?ID=3620>; "汽车产业调整振兴规划" (March 20, 2009) on the official website of The Central People's Government of the People's Republic of China, http://www.gov.cn/jwgc/2009-03/20/content_1264324.htm#, as viewed on August 19, 2009. The US-China Business Council released a brief English-language summary, "USCBC Summary of the PRC Auto Industry Revitalization Plan." The author used the original Chinese-language version of the document.

⁶⁹ *Economist Intelligence Unit*, "Industry Report: Automotive July 2009."

⁷⁰ *Automotive News*, "2009 Guide to China's Auto Market," April 27, 2009, p.20. The incentives are reported to be a fixed amount of \$8,770 for an electric car and up to \$7,310 for a hybrid.

Policy Shift on Foreign Investment

Every few years, the National Development and Reform Commission (NDRC), China's top economic planning agency, releases a "Foreign Investment Catalogue" that groups foreign investment into broad categories: encouraged, permitted, and restricted. The catalog is usually considered a bellwether that reflects broad guidelines to be followed by other government agencies and local authorities, which would introduce and implement specific policies accordingly. For example, streamlined or expedited approval process and preferential tax structures are often used to encourage foreign investment.

In the latest NDRC catalog, published in late December 2011, foreign investment in automobile manufacturing has been removed from the "encouraged" category, due to the government's concerns over potential overcapacity and "blind investment." At the same time, alternative-energy vehicles have been moved up into the "encouraged" category.⁷¹

This significant policy change, which ended the incentives offered to foreign auto makers for the past seven years, reverberated through the global auto industry as the Chinese market has become a centerpiece of many automakers' global growth plans. Many auto industry experts agree that the move by the NDRC to rein in gains by foreign companies and strengthen its domestic companies will affect foreign companies in coming years, especially those hoping to break into the Chinese market, such as Chrysler and Renault. Foreign auto makers doing business in China, in general, could face cost increases and become more reliant on their Chinese partners.⁷²

Indigenous Brands and Industry Consolidation

A major objective set out by the 12th Five-Year Plan⁷³ for the Chinese auto sector is to improve domestic automakers capability to produce complete vehicles, in addition to auto parts, and to develop indigenous capacity to produce key components. This was not the first time that the central government promoted national brands, as *Ward's Automotive Yearbook 2008* stated, "although China's 11th five-year plan (2006-2010) for the auto industry included an article requiring such development of indigenous brands, it was not officially promulgated in early 2007 as originally scheduled."⁷⁴

Given the rapid growth of China's auto industry and the apparent ambitions of several domestic automakers, it could be a matter of time for the Chinese government to be more aggressive in promoting the creation of domestic brands by Chinese firms, especially those who are partners in foreign joint ventures.

From China's perspective, cooperation with foreign car makers has achieved little in terms of development of local brands or acquiring key technology. Although no central government ruling or written policy is known to have explicitly directed foreign carmakers to develop a local car brand for the Chinese market, foreign auto companies wishing to build new plants or add capacity

⁷¹ *The Wall Street Journal*, "China Downshifts on Autos, Boosts Energy in Foreign-Investment Review," December 31, 2011.

⁷² *Automotive News China*, "China Limits Foreign investment in Auto Sector," January 3, 2012; *The Wall Street Journal*, "Foreign Auto Makers Reassess China," January 6, 2012.

⁷³ *Twelfth Five-Year Plan for National Economic and Social Development* on the official website of The Central People's Government of the People's Republic of China; see http://www.gov.cn/2011lh/content_1825838.htm, as viewed on April 18, 2012. Five-year plans are a series of social and economic development plans issued by the central government as the overall principles directing the country.

⁷⁴ *Ward's Automotive Yearbook 2008*, p. 38.

have been advised by the government to develop a local car brand and establish R&D facilities for their Chinese joint ventures, and to add electric vehicles to their product lineups.⁷⁵

According to a *Financial Times* report published in March 2011, a PSA Peugeot Citroen executive said that a local brand was “part of the deal” in its new joint venture with Chinese car producer Changan; VW, which then was seeking to build a new plant in southern China (this new plant in Foshan was approved and is being built), confirmed that it was in discussions with its Chinese partners to develop local brands.⁷⁶

Industry experts observe that the indigenous brand issue has been specifically linked in expansion talks and question whether such a drive into local brands makes business sense at a time when the central government, as well as most carmakers, is trying to reduce complexity. “None of the manufacturers freely opted for having local brands added to a complex brand portfolio that they all already had,” one industry consultant concluded. “It’s clearly something driven out of the political class in China with long-term interests in mind.”⁷⁷

Honda Motors and General Motors, reportedly, have started producing models for their local brands, albeit with different approach. Honda launched Everus S1, which is just a rebadged older model of Honda Fit, for its joint venture, Guangqi Honda. The Everus model is sold through the same dealership network for Honda vehicles, including the new Honda Fit, and reportedly only 2,000 units are sold per month. At the request of the local government in Liuzhou (one of the owners of the SAIC-GM-Wuling joint venture), GM introduced a local brand, Baojun 630. The new model was developed by Pan Asia Technical Automotive Center (PATAC), GM’s R&D center in Shanghai and is a true addition to the joint venture, which is a leading microvan producer with no cars in its portfolio at that time. Positioned as an entry-level car and priced lower than local GM cars, this local brand is marketed through a new dealership network. Baojun appears to have fared better than Everus and sold 22,000 units during the first three months in 2012.⁷⁸

However, industry analysts are not optimistic that other joint-venture brands will be able to emulate Baojun’s success. They contend that indigenous car brands were created not to satisfy market demand, but to meet the central government’s requirements. Secondly, they doubt that these brands would get full support from their international parent companies because the new brands are owned by the joint ventures.⁷⁹

The Blueprint for Industry Transformation and Upgrade 2011-2015 reiterates the central government’s goal for automakers to consolidate operations and improve technology. According to the directive, China’s 10 domestic automakers and their joint ventures with foreign partners are expected to produce more than 90% of the vehicles. In 2011, these companies produced about 16 million vehicles and accounted for 87% of total auto production in China.⁸⁰

⁷⁵ Yang Jian, *Automotive News China*, “China Joint Ventures’ Baby Brands Face Murky Prospects,” April 24, 2012.

⁷⁶ John Reed and Patti Waldmeir, *Financial Times*, “Foreign Groups Told to Make Chinese Cars,” March 20, 2011.

⁷⁷ Ibid.

⁷⁸ Yang Jian, *Automotive News China*, “China joint ventures’ baby brands face murky prospects,” April 24, 2012.

Baojun 630 is based on the platform of Buick Excelle but can be considered a new model since its interiors and exteriors are redone.

⁷⁹ Ibid.

⁸⁰ *The Blueprint for Industry Transformation and Upgrade 2011-2015*, on the official website of The Central People’s Government of the People’s Republic of China; see http://www.gov.cn/zwzk/2012-01/18/content_2047619.htm, as viewed on April 25, 2012; *Automotive News China*, “Beijing expects 10 automakers to assemble 90% of China’s

Most mergers and acquisitions have taken place among state-owned auto companies. For example, in 2008 SAIC acquired Nanjing Automobile Group; in 2009, Changan acquired two state-owned carmakers, Jiangxi Changhe Automobile Co. and Hafei Automobile Industry Group Co.⁸¹

Energy-Saving and New-Energy Auto Industry Plan (2012-2020)

The Chinese central government and all levels of local government have been promoting production of alternative energy vehicles, such as pure electric and plug-in hybrid vehicles cars, since China became a major auto producer. They hope to adopt new technologies quickly, leapfrog industrialized countries that are mature markets for mostly gasoline- or diesel-fuel cars, and become a major global player in this new field. By promoting the new energy and energy-saving vehicles, the government also hopes to reduce oil consumption and address environmental issues such as air pollution in big cities.

Support and fiscal incentives from the central government, local provinces, and municipalities have spurred a surge in projects to produce alternative-energy vehicles and technologies. For example, the municipality of Beijing has moved to exempt electric and plug-in hybrid vehicles from license-plate limits;⁸² the Shenzhen city government, like several other provincial and municipal counterparts, has announced support for advanced technology initiatives. Shenzhen provided fiscal support to BYD Auto Company.⁸³ BYD Auto Co. is the car manufacturing subsidiary of one of the world's largest battery manufacturers. American investor Warren Buffet's investment firm, Berkshire Hathaway, bought a 10% stake in BYD in 2008. BYD produces conventional and electric vehicles and has repeatedly announced plans to export to the U.S. auto market, which are yet to materialize.⁸⁴ In October 2011, BYD America opened an office in Los Angeles, but delayed plans to sell electric cars to retail buyers, citing lack of public chargers. Reportedly, it plans to focus on solar panels, batteries, LED lighting, and rechargeable buses.⁸⁵

At the same time, the central government also offers various incentives to promote sales of new energy vehicles. Government subsidies of up to 60,000 yuan (nearly \$9,500, at 6.32 yuan/dollar) for a pure electric car and 50,000 yuan (approximately \$7,910) for a plug-in hybrid are available in five Chinese cities, including Shanghai and Shenzhen. In addition to the incentives from the central government, some local governments also offer subsidies to consumers. In Shenzhen, for example, the municipal government offers up to 60,000 yuan for an electric car and 30,000 yuan for a plug-in hybrid.⁸⁶

vehicles by 2015," February 3, 2012.

⁸¹ *Automotive News China*, "Beijing expects 10 automakers to assemble 90% of China's vehicles by 2015," February 3, 2012.

⁸² Wards Auto, "China Charges Ahead for EV Dominance as Auto Sales Slow," October 24, 2011.

⁸³ *The Wall Street Journal*, "Buffet's China Car Play Sags," August 24, 2011. Since the summer of 2010, however, BYD's car sales have been slipping because of competition from affordable compact cars launched in China by other automakers, such as GM's Chevy Sail compact car. BYD's sales suffered further when the Chinese government stopped providing vehicle purchase incentives.

⁸⁴ BYD Auto, "China's BYD Auto Plants To Sell Hybrids in U.S.," January 11, 2008; <http://www.byd.com/press.php?id=7>; *Financial Times*, "BYD to Sell Electric Car in U.S. in 2010," August 31, 2009; *Financial Times*, "BYD a Victim of Its Own Grand Predictions," October 26, 2011.

⁸⁵ Bloomberg.com, "Buffet's Chinese Car Investment Fails to Bring Los Angeles Promised Jobs," October 23, 2011.

⁸⁶ *Automotive News China*, "Chinese Reluctant to Pay More for EVs, survey finds," May 6, 2011; *Automotive News*, "Engineer: Government Subsidies Will Heat Up China's EV Market," June 14, 2011.

However, these subsidies do not seem to have stimulated consumer demand for new-energy vehicles as expected. In 2011, only 8,159 new energy vehicles were sold in China, including those used in government pilot programs for e-taxis and e-buses.⁸⁷ In addition to the high prices (after subsidies), many consumers are also concerned about premature technology and the safety record of these vehicles. Some other reasons cited by media reports include limited model selection and inadequate charge infrastructure.⁸⁸

In April 2012, China's State Council approved *Energy-Saving and New-Energy Automotive Industry Plan 2012-2020*, the first official development guideline for this specific segment of the auto industry. The plan sets ambitious goals to have half a million electric cars and plug-in hybrids on the road by 2015 (a revision from the previous goal of 1 million), and 5 million by 2020. According to the plan, the government will expand pilot programs, offer purchase incentives, support research and development programs, build vehicle recharging facilities, and develop a plan to recycle batteries.⁸⁹

Support from the central and local (i.e., provincial or municipal) governments, who often favor "local champions," runs a very real risk of research duplication and market fragmentation, which would lead to inefficiency and redundancy.⁹⁰ This, coupled with consumer reluctance, presents challenges to the central government's ambition to leapfrog a generation of conventional engine technology and gain an advantage over the West in new-energy vehicles, especially electric cars.

Chinese Government Fleet Procurement

The Chinese government spends a significant amount of government money on vehicle procurement, often with preferences for luxury cars such as the Audi A6 and Mercedes-Benz E-Class. A *Wall Street Journal* report cited Xinhua, the Chinese official news agency, that the annual official vehicles procurement budget is more than 100 billion yuan (approximately \$15.6 billion, at 6.4 yuan/dollar) in 2011.⁹¹ *Automotive News China* estimates that China's government (at all levels) spends as much as 200 billion yuan annually (approximately \$31.3 billion) on vehicle purchases and maintenance.⁹²

In November 2011, the Chinese central government issued new rules that require government officials to spend less on vehicles for official use and buy more fuel-efficient, small vehicles, including electric cars (see **Text Box**). These new rules underline policymakers' concerns over rising fuel consumption in China, on both economic and environmental grounds. They also came amid rising public criticism over waste and corruption among public servants.

China Curbs Bureaucrats' Car Perks

China issued new rules for vehicles purchased for official use in November 2011, which lower the maximum amount of public funds that "regular" (mid-level) government officials can spend on vehicles from 200,000 to

⁸⁷ Reuters.com, "China's Charge Slows on Electric Car Ambitions," April 25, 2012.

⁸⁸ *Automotive News*, "Engineer: Government Subsidies Will Heat Up China's EV Market," June 14, 2011; *Automotive News China*, "China Falls Behind in Readiness for Electric Vehicles," April 21, 2012;

⁸⁹ The Chinese central government website: http://www.gov.cn/ldhd/2012-04/18/content_2116641.htm, as viewed on May 8, 2012; China Daily, "Nation Sets Focus on Electric, Hybrid Cars," April 19, 2012.

⁹⁰ *Economist Intelligence Unit*, "Automotive Briefing & Forecasts: China Fuels: China Bets on Electric Vehicles," April 30, 2009.

⁹¹ *The Wall Street Journal*, "China Targets Bureaucrats' Car Perks," November 26-27, 2011.

⁹² Yang Jian, *Automotive News China*, "Why is China's Luxury Market So Hot?" April 29, 2011.

180,000 yuan (about US \$28,400). These new rules also require officials to purchase vehicles with engines smaller than 1.8 liters (previously the limit on engine size was 2 liters). The government also added “new-energy vehicles” (i.e., all electric cars and plug-in electric hybrids) to the list of cars that meet purchase requirements.

Industry analysts seem to agree that these rules may not have much impact on what cars officials would purchase. Some suggest that mid-level officials may choose to settle for less expensive vehicle models or just find loopholes. Foreign automakers may fit vehicles with smaller engines to meet the requirements. For example, Volkswagen reportedly is introducing a version of the Passat with a smaller engine.

Source: *The Wall Street Journal*, “China Targets Bureaucrats’ Car Perks,” November 26-27, 2011.

The Chinese government has urged government agencies to buy domestic brands for years. In 2009, Beijing decreed that domestic nameplates should account for at least 50% of government fleet purchases. However, few seem to have followed the requirement—foreign brands, the products of auto joint-ventures, reportedly accounted for about 80% of the official vehicle pool.⁹³

In February 2012, the Chinese Ministry of Industry and Information issued a preliminary list for official fleet procurement, which excludes foreign brands (such as GM, VW, and Toyota) and limits vehicle models to 412 models made by Chinese automakers. If approved and implemented, this list would give Chinese automakers an advantage in a fleet market worth about 120 billion yuan (approximately \$19 billion, at 6.3 yuan/dollar), although some industry analysts doubt if such a policy would benefit domestic car manufacturers in the long run and make them more competitive.⁹⁴

This proposed procurement list has caused concerns among foreign car companies. The European Union Chamber of Commerce (the Chamber), whose members include Volkswagen AG and Daimler AG, said it would assess the effect of this proposal and might discuss the issue with the Chinese government. The Chamber also cautioned that such a move may prompt other countries to raise similar hurdles if Chinese automakers sought to expand overseas.⁹⁵

Impact of China on the U.S. Automotive Market

Chinese-Made Vehicle Imports Not Imminent

The number of vehicles produced in China annually more or less equals the number of vehicles sold there, with both exports and imports at relatively low levels. In 2005, China became a net exporter of vehicles for the first time, with 172,800 export units. Since then, the country’s motor vehicle exports have been growing. According to China Association of Automobile Manufacturers (CAAM), China exported a total of 849,800 units in 2011, of which 56% were passenger vehicles, while 44% were commercial vehicles.⁹⁶

The vast majority of China’s vehicle (cars and trucks) exports are by domestic companies such as Geely, Chery, and Great Wall. Vehicles made by independent domestic automakers, as opposed to those built by Chinese joint venture partners, account for more than 70% of the total exports,

⁹³ Bloomberg.com, “Chinese Carmakers Surge on Official Vehicle List: Beijing Mover,” February 26, 2012; China.org.cn, “China: Government Vehicles to Be Domestic Brand Only,” March 1, 2012; Yang Jian, *Automotive News China*, “Why Banning Foreign Fleet Purchases Won’t Rescue China’s automakers,” March 2, 2012.

⁹⁴ Calculated based on the reported 120 billion yuan to be spent on fleet purchased for official use. China.org.cn, “China: Government Vehicles to Be Domestic Brand Only,” March 1, 2012.

⁹⁵ Bloomberg.com, “China Automakers Mat Face European Hurdles, Chamber Says,” March 5, 2012.

⁹⁶ CAAM (www.caam.org.cn) statistics, January 19, 2012.

while the remainder were exported by non-Chinese manufacturers. For example, in later 2011, Honda Motor began exporting its Fit subcompact cars to Canada from its plant in China; GM exports Chinese-made mini commercial vans and the Chevrolet Sail compact mainly to South America. It also exports vehicles to Egypt and Libya.⁹⁷

Most Chinese car exports are destined for developing countries in Africa, the Middle East and Southeast Asia, where their unit prices are reported to be less than \$15,000, with some selling for as low as \$6,000.⁹⁸ Vehicle exports to Russia and Brazil rose quickly in 2010, and accounted for more than 10% (or 56,500 units) of Chinese auto exports in 2010. Some EU member states, such as Romania, Poland, and the Czech Republic, have also seen an increase of motor vehicles imported from China.⁹⁹ Some Chinese automakers began setting up plants in their overseas markets: Chery opened a plant in Venezuela in 2011 and reportedly is building an assembly operation in Brazil; Great Wall, according to its website, has production facilities in Bulgaria, Senegal, the Philippines, Indonesia, Iran, Vietnam, and Egypt.¹⁰⁰

In 2005, American entrepreneur Malcolm Bricklin undertook widely publicized efforts to form a 200-dealer network (named Visionary Vehicles or V cars) aimed at selling 250,000 Chery-made vehicles in the U.S. market by 2007. After delaying the start of sales several times, Bricklin reportedly postponed his plan until late 2008 in order to meet the U.S. government crash-test safety requirements.¹⁰¹ In July 2008, Bricklin filed a lawsuit against Chery Automobile Co., along with some of its affiliates and officials, and severed ties with Chery.¹⁰² No Chery vehicles were sold in the United States. Another Chinese domestic car producer, the aforementioned BYD Auto Co., has repeatedly delayed plans to export to the U.S. market.¹⁰³

Attempts to export more vehicles to developed-country markets (such as the United States and the EU) have been repeatedly delayed due to poor product quality and the failure of Chinese domestic brands to meet safety and emissions requirements. A domestic automaker, Jiangling Motors Co. Ltd., debuted its Landwind X6 SUV in Europe in 2006 and was widely criticized by the European media for its lack of safety features and poor handling. The German automobile club, Allgemeiner Deutscher Automobil-Club (ADAC), which also conducts crash testing, reportedly insisted it be banned from European roads.¹⁰⁴ In 2007, another Chinese domestic vehicle manufacturer, Brilliance Auto, was forced to put its European export plans aside after one

⁹⁷ *The Wall Street Journal*, "China Ramps Up Car Exports," April 25, 2012.

⁹⁸ CAAM (www.caam.org.cn) statistics, January 19, 2012: The top 10 destinations for Chinese vehicles in 2011 are: Algeria, Iran, Iraq, Chile, Russia, Venezuela, Egypt, Peru, Colombia, and Nigeria.

⁹⁹ *Economist Intelligence Unit*, "Industry Briefing: China Cars: Export Ambitions Postponed?" August 22, 2008; CAAM (www.caam.org.cn) statistics, February 15, 2011.

¹⁰⁰ *Automotive News China*, "Export King Chery's Overseas Sales Leap 21%," February 14, 2012; *Economist Intelligence Unit*, "Industry Briefing: Bulgaria Cars: Double First," February 21, 2012.

¹⁰¹ *Ward's Automotive Yearbook 2007*, p. 38.

¹⁰² On July 20, 2008, V Cars filed a Complaint against Chery under the Federal Racketeer Influenced and Corrupt Organizations ("RICO") Act and state law of Michigan. In the complaint, V Cars LLC claims Chery induced V Cars into giving it plans for a North American distribution business, subverted a highly placed employee, and committed acts of fraud after it decided not to go through with a deal it made with V Cars. RICO; 18 U.S.C.A. § 1961 et seq. [1970]; *Forbes.com*, "Brickbats For Chery," July 20, 2008; Reuters, "Malcolm Bricklin Announces Filing of V Cars, LLC Racketeering and Corruption Complaint Against Chery Automobile Co." July 21, 2008; <http://www.reuters.com/article/2008/07/21/idUS148667+21-Jul-2008+MW20080721>.

¹⁰³ BYD Auto, "China's BYD Auto Plants To Sell Hybrids in U.S.," January 11, 2008; <http://www.byd.com/press.php?id=7>; *Financial Times*, "BYD to Sell Electric Car in U.S. in 2010," August 31, 2009; *Financial Times*, "BYD a Victim of Its Own Grand Predictions," October 26, 2011.

¹⁰⁴ *Ward's Automotive Yearbook 2007*, p. 38.

Brilliance car scored the worst crash test results in the history of ADAC. Furthermore, a recording of a Brilliance car failing a crash test was later broadcast on YouTube, an Internet video-sharing site, damaging the brand.¹⁰⁵

However, Chinese automakers are building on these experiences and investing in better vehicle safety. Their efforts in improving product quality and safety have resulted in some progress in this regard. In late 2011, SAIC's MG6 compact car and Geely's Emgrand EC7 mid-size car received a four-star (out of five stars) overall rating in crash tests by Euro NCAP, a European agency assessing vehicle safety.¹⁰⁶

Some major auto producers have been exporting motor vehicles from China. One of the leading foreign manufacturers using China as an export platform is Honda. One of its operations is a joint venture in Guangzhou producing sedans solely for export. Chinese regulations, in general, prohibit multinationals from owning more than 50% of auto assembly joint ventures in China. But the government made an exception in 2003 and allowed Honda to own 65% of the assembly plant in Guangzhou, because the output is solely for export. In 2005, this operation accounted for 25% of China's passenger car exports, including 9,700 Honda Jazz subcompacts to Europe.¹⁰⁷ GM announced in August 2009 that its SAIC-GM-Wuling joint venture would begin exporting two of its most popular mini-commercial vehicles under the Chevrolet brand to South America, North Africa, and the Middle East. Exports to Peru reportedly began in July 2009.¹⁰⁸

In May 2009, various news sources reported that GM was planning to build a new small car in China for export to the United States.¹⁰⁹ It was also reported that GM planned to sell about 17,300 Chinese-made vehicles in the United States in 2011 and then to triple the volume to 51,500 in 2014. However, such plans drew immediate opposition from some Members of Congress and the United Auto Workers (UAW).¹¹⁰ In negotiations with the UAW in May 2009, GM announced that it would invest in a new compact and small car assembly plant in the United States capable of producing 160,000 annual units of production. This was widely reported as a concession to the UAW.¹¹¹ A GM plant in Orion, MI, was selected as the site to build the new small car, which has begun production of the Chevrolet Sonic.

¹⁰⁵ *Economist Intelligence Unit*, "Industry Report: Automotive July 2009."

¹⁰⁶ Euro NCAP News Release, "Chinese Manufacturers Investing in Safety," November 23, 2011.

¹⁰⁷ *New York Times*, "China Looms as the World's Next Leading Auto Exporter," April 22, 2005; *Wall St. Journal*, (February 15, 2006); and IBM Business Consulting Services, *Inside China*, 2005, p.17.

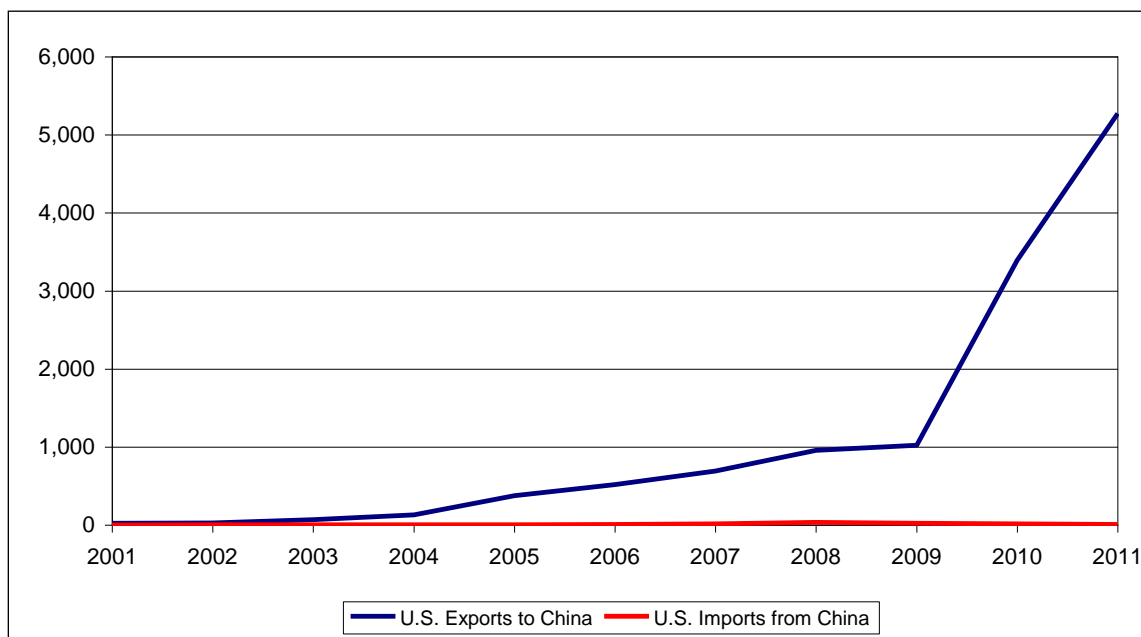
¹⁰⁸ GM China website, <http://www.gmchina.com>, "GM Communications: SAIC-GM-Wuling Signs Agreements to Export Mini-Commercial Vehicles to South America, Middle East, and North Africa," August 13, 2009.

¹⁰⁹ *Automotive News*, "GM Plans to Export China-made Cars to U.S.," May 12, 2009; *BusinessWeek*, "GM looks to China, the UAW Looks to the Feds," May 14, 2009; *Automotive News*, "GM Plans to Import Small Chevys from China," May 18, 2009.

¹¹⁰ *Automotive News China*, "GM plans to Import Small Chevy from China," May 20, 2009.

¹¹¹ UAW, UAW-General Motors Modifications to the 2007 Agreement and Addendum to VEBA Agreement, May 2009; *Detroit Free Press*, "Tenn. Plant May Be GM Long Shot," June 13, 2009; and *Washington Post*, "Under Restructuring, GM to Build More Cars Overseas," May 8, 2009.

Figure 5. U.S.—China Trade in Motor Vehicles
(\$ Millions)



Source: U.S. International Trade Administration. U.S. Automotive Trade Data and Data Links, "U.S. Automotive Trade, 2000-2011."

China, thus far, has played little part in terms of exporting motor vehicles to the United States. Most of the vehicles imported into the United States from China, so far, have been largely limited to multi-use small trucks and vans for off-road use. As illustrated in **Figure 5**, the United States had a trade surplus with China in motor vehicles in 2011. U.S. exports to China were nearly \$5.3 billion and imports totaled \$9 million.¹¹²

In 2011, the United States exported 136,222 units of new passenger vehicles and light trucks to China, making it the fourth-largest export market in volume for U.S.-produced vehicles. The top five markets for U.S. vehicle exports in 2011 were Canada, Mexico, Germany, China, and Saudi Arabia.¹¹³

The Chinese Auto Parts Sector

U.S. imports of Chinese auto parts, on the other hand, have expanded rapidly. In 2011, U.S. imports of auto parts from China were over \$12 billion.¹¹⁴ From 2001 to 2011, the value of auto parts imported from China to the United States has increased nearly six times (see **Figure 6**). After brief stagnation due to the global economic downturn, U.S. imports of Chinese auto parts surged between 2009 and 2011, becoming the second-largest source of U.S. imports of auto parts,

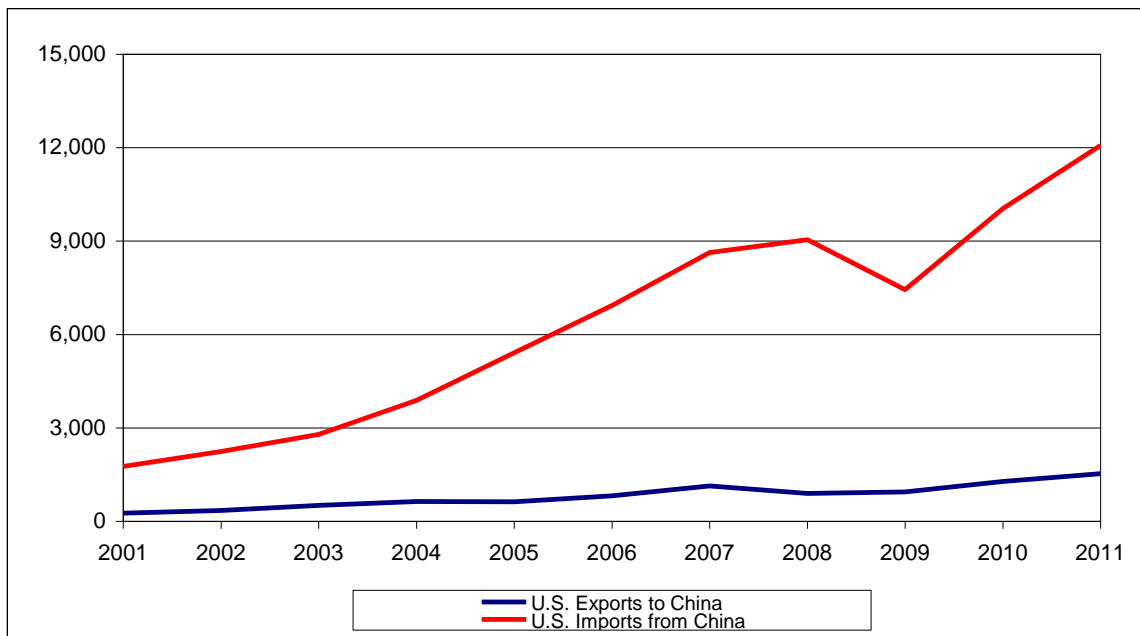
¹¹² U.S. International Trade Administration (USITA); U.S. Automotive Trade 2000-2011, as viewed on June 12, 2012. http://www.trade.gov/mas/manufacturing/OAAI/build/groups/public/@tg_oaai/documents/webcontent/tg_oaai_003775.pdf

¹¹³ USITA, "Growth Trends in U.S. Vehicle Exports," April 26, 2012.

¹¹⁴ For comparison, U.S. exports of auto parts to China was over \$1.53 billion in 2011.

behind only Japan.¹¹⁵ This has caused concerns among labor and trade activists as well as some congressional Members from industrial states (see below).

Figure 6. U.S.—China Trade in Auto Parts
(\$ Millions)



Source: U.S. International Trade Administration, U.S. Automotive Trade Data and Data Links, "U.S. Automotive Trade, 2000-2011."

It is estimated that there were over 10,000 registered auto parts companies in China as of 2008, according to a briefing paper published by the Economic Policy Institute (EPI), while there are about 15,000 non-registered companies whose diversified operations include production of auto parts.¹¹⁶ Within this highly fragmented auto parts industry, foreign companies constitute 7 out of the 10 largest auto parts producers in China. In 2009, more than 70% of the leading global auto parts companies, such as Bosch, Visteon, Denso, and Johnson Controls, had manufacturing operations in China, while many continue to open or expand their Chinese operations.¹¹⁷ This significant presence of foreign auto parts producers in China (including American companies) and the extensive integration of these companies into the Chinese export mechanism explain the sharp rise of U.S. auto parts imports from China.

There are a few additional reasons for foreign parts makers to build facilities in China:

- First, unlike the 50% cap on foreign ownership in vehicle manufacturing companies, there are no limits on foreign investment in the automotive parts sector. This means international companies can set up wholly foreign-owned auto parts companies in China, without concerns over transferring advanced technology to local partners.

¹¹⁵ USITA U.S. Automotive Trade 2000-2011, as viewed on June 12, 2012.

¹¹⁶ Usha C.V. Haley, *Putting The Pedal to The Metal*, Economic Policy Institute, Briefing Paper #316, January 31, 2012, p.3.

¹¹⁷ Measured by number of factories; *ibid*, p.6.

- Second, the Chinese government increased the tariffs on imported auto parts from 10% to 25% if imported parts made up more than 60% of the finished vehicle's value. This controversial tariff, which resulted in a WTO dispute case, is discussed later in this report.
- Other important factors include production logistics, competitive labor costs, and an increasingly skilled labor force.¹¹⁸

As China's economy continues to grow and living standards continue to rise, wages and benefits will likely increase as well. The U.S. auto industry also has restructured and its labor costs are becoming more competitive. The rising costs and pressure for China to allow its currency to appreciate further suggest that the comparative advantage of a cheap Chinese labor force could become less significant over time.

In fact, waves of labor unrest rippled through multiple factories in China in 2010 and 2011 and disrupted the operations of global corporations, as workers demanded higher wages and improved work conditions. These global companies include Foxconn, the world's largest contract electronics manufacturer (whose clients include Apple, Dell and HP); Japanese car makers Toyota and Honda; and Korean electronics company LG. Almost all the strikes and disruptions resulted in a sizable pay raises between 20% and 30%.¹¹⁹

Local governments also moved to increase minimum wages, which reportedly rose nationwide by 22% between 2010 and 2011.¹²⁰ Different regions adjust wages competitively to address rising living costs and attract a new generation of migrant workers because China's one-child policy has led to a systemic labor shortage.

Vehicle and parts manufacturers also need to contain shipping costs, which reflect fluctuations in the price of oil. According to the *Economist*, the cost of shipping a standard 40-foot container between Shanghai and America's East Coast, for example, jumped from \$3,000 in 2000 to about \$8,000 in 2008.¹²¹ While the cost of container shipments subsequently declined with the onset of the global recession, the advantage of extensive supply chains may only apply when shipping costs are inexpensive. For all but the most labor-intensive parts, the attraction of low labor costs may not be sufficient to offset the high costs of maintaining a trans-Pacific supply chain. The close proximity between car makers and their suppliers is crucial to better just-in-time (JIT) inventory and production management.

The quality of locally sourced Chinese auto parts was not up to expectations in the early years of the Chinese auto sector. Frank Ogden, vice president of global supplier development for the PAC group, a Shanghai based consulting company, was quoted in *Who Really Made Your Car?*, a book on the auto parts industry by Thomas Klier and James Rubenstein, "Only 15 percent of Chinese suppliers can meet those standards ... Problems range from not knowing how to meet a

¹¹⁸ As noted in a recent *Washington Post* article, "Under Restructuring, GM to Build More Cars Overseas," May 8, 2009: "Labor costs in those countries are far lower. While paying a U.S. autoworker with benefits costs about \$54 an hour, a South Korean worker earns about \$22 an hour, a Mexican worker earns less than \$10 an hour and some Chinese workers can earn as little as \$3 an hour, industry sources said."

¹¹⁹ *Financial Times*, "Strike Stalls Honda's China Output," May 28, 2010; *The Detroit News*, "Honda Gives Striking China Workers Wage Boost," June 1, 2010; *Financial Times*, "Foxconn Raises Pay by 30% in China," June 2, 2010; Bloomberg.com, "Honda's Worst China Strikes May Cut Profits by 10 Billion Yen," June 17, 2010; Bloomberg.com, "Toyota Shuts China Plant; Honda Hit by Fourth Affiliate Strike," June 18, 2010; *Financial Times*, "Workers Call the Tune in China," February 22, 2011; *Financial Times*, "Labor Unrest Sweeps China," December 29, 2011.

¹²⁰ *Financial Times*, "Chinese Cities Raise Minimum Wage," January 5, 2012.

¹²¹ *Economist Intelligence Unit*, "Industry Briefing: China Cars: Export Ambitions Postponed?" August 22, 2008.

customer's deadlines to inadequate testing of raw materials." Nevertheless, parts quality has improved considerably, as noted by Klier and Rubenstein:

China has seen rapidly improving quality. GM's defect rate for parts in China declined from 2,197 per million in 1999 and 1,397 per million in 2000 to only 23 per million in 2003. In comparison, GM's worldwide defect rate in 2003 was much higher (35 per million) and only slightly lower (22 per million) in the United States.¹²²

Shanghai and the surrounding provinces of Jiangsu, Zhejiang, and Anhui are the leading centers for the manufacture of auto parts, accounting for about 40% of total production. Other export-oriented parts-manufacturing hubs include Guangzhou, Chongqing, and Changchun.¹²³

China's domestic automotive-parts manufacturers typically have limited R&D capacity and, as a result, are usually restricted to the production of lower-end products, such as tires, wheel hubs, and other labor-intensive products. However, there are signs that the domestic parts manufacturers are trying to move up the value chain. As previously mentioned, in June 2009, Geely announced the acquisition of an Australian company, Drivetrain Systems, which may allow Geely to improve its development of gearboxes and move up the technological ladder.¹²⁴ The same can be said for BYD Auto Company and other independent producers. As they develop new automotive technologies (such as batteries and electric systems for cars) over time, they could emerge as significant competitors to American companies.

The Chinese Auto Sector: Issues and Implications

Chinese Auto Sector Commitments

As discussed earlier, the *Chinese Automotive Industrial Policy of 2004* abolished many formal restrictions and domestic content rules, but still contained provisions discouraging the importation of auto parts and encouraging the use of domestic technology. For example, the U.S. Trade Representative (USTR) expressed concerns about the vague and unclear nature of many statements in the 2004 policy (such as China's plans to regulate imports via its new registration system for auto manufacturers and China's treatment of complete knockdown kits).¹²⁵ Moreover, the 2004 policy still required foreign-owned assemblers in China to operate through joint ventures, with no more than 50% of ownership.

The United States and other countries contend that the Chinese government may be seeking to establish de facto policies that would restore or maintain local content rules that it was required to abolish as part of its WTO accession agreement in 2001. With respect to its WTO commitments, China reduced its duties on imported cars from 61.7% for large cars and 51.9% for small cars to a unified rate of 25% on imported vehicles and 10%-14% on parts by July 1, 2006.¹²⁶

¹²² Klier and Rubenstein, *Who Really Made Your Car?*, p. 323.

¹²³ *Economist Intelligence Unit*, "Industry Report: Automotive July 2009."

¹²⁴ *Ibid.*

¹²⁵ Executive Office of the President, Office of the U.S. Trade Representative, *2004 National Trade Estimate Report on Foreign Trade Barriers* (April 2004), p.79.; World Trade Organization, "China's Transitional Review Mechanism: Communication from the United States," G/MA/W/58 (Doc. 04-3613, August 31, 2004), p.2.

¹²⁶ Information from U.S. Dept. of Commerce, International Trade Administration Offices of China Enforcement, and Aerospace and Automotive Industries, February 23 and September 18, 2006.

However, China had subsequently established a regulation, *Measures on Importation of Parts for Entire Automobiles*, which effectively re-established discrimination in favor of local content. Motor vehicle manufacturers were required to register their parts. If more than 60% of the value of a vehicle was accounted for by imported parts, the manufacturer had to pay duties of 25% on all imported parts in the vehicle.¹²⁷ On August 28, 2009, China announced its decision to eliminate additional charges on aforementioned imported auto parts, effective September 1, 2009.¹²⁸

Protection of Auto Intellectual Property Rights

Another issue that has been of persistent concern has been protection of intellectual property rights (IPR) in China. The United States has brought two IPR-related cases against China before the WTO. In April 2012, after a review by the United States of the Chinese compliance with its commitments under the WTO IPR rules, China remained on the Office of the U.S. Trade Representative's "Priority Watch" list for insufficient IPR enforcement. In its *2012 Special 301 Report*, the USTR states:

A wide spectrum of U.S. rights holders reports serious obstacles to effective protection and enforcement of all forms of IPR in China, including patents, trademarks, copyrights, trade secrets, and protection of pharmaceutical test data. Compounding these obstacles is the troubling direction that China's policies in the IPR area that have taken place recently. These policies include China's efforts to link eligibility for government preferences to the national origin of the IPR in products. In addition, many companies are concerned that Chinese government agencies are inappropriately using market access and investment approvals as a means to compel foreign firms to license or sell their IPR to domestic Chinese entities.¹²⁹

IPR issues have created problems for U.S. and other foreign automotive manufacturers operating in China. The most notable example was GM's case against Chery, alleging that the local automaker's QQ model was a nearly identical copy of the Chevrolet Spark, a minicar designed by GM's Korean subsidiary, GM Daewoo. After a Chinese court in September 2005 found that the design of the Spark was never patented in China, GM and Chery reached a separate settlement of all issues. Although terms of the agreement were not disclosed, reportedly, Chery has agreed not to use its company name when marketing cars in the United States, because of its similarity to the Chevy trade name.¹³⁰

China's independent carmakers have variously been accused of using reverse engineering and copying of foreign brands and models in pursuit of growth. For the moment, it maybe questionable whether any of China's independent automakers will be able to make a successful leap to international export markets, because it requires that they produce comparable high

¹²⁷ China has a maximum tariff of 25% for imported cars, but only 10% on auto parts. This new system was to levy higher tariffs on auto parts once the 60% threshold was reached, in effect treating the imported parts as vehicles. Beijing was concerned that foreign automakers could import vehicles in large parts to circumvent the higher tariff.

¹²⁸ USTR, August 31, 2009 press release, <http://www.ustr.gov>; WTO Dispute Settlement DS340, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds340_e.htm; *The Economic Times*, "China moves to cut tariffs on auto part imports," August 29, 2009.

¹²⁹ USTR, *2012 Special 301 Report*, April 2012, p.p. 26-27.

¹³⁰ IBM Business Consulting Services, *Inside China*, 2005, p. 13; *Detroit News AutoInsider*, "GM Settles Piracy Dispute with Chinese Automaker" (November 18, 2005); *The Wall St. Journal*, "GM Settles Legal Feud with Chinese Auto Maker" (November 18, 2005);

quality automobiles and light trucks that meet safety standards and respect the intellectual property rights of other auto manufacturers.

The Chinese government has been pressuring all foreign-Chinese car manufacturers to develop local brands (i.e., jointly designed brands with their Chinese partners) aimed at small car buyers at the lower end of Chinese car market, as part of the drive to boost “indigenous innovation.” This has sparked complaints from multinational companies. Some foreign carmakers assert that the drive for joint venture brands is nothing more than a “technology shakedown” to force them to share technology with their domestic partners.¹³¹

In early September 2011, GM was reportedly under pressure from the Chinese government to share some of the core technology of its new Chevrolet Volt plug-in hybrid. According to press accounts, Chinese government refuses to let the Volt qualify for subsidies up to \$19,300 unless GM agrees to transfer the engineering secrets for one of the Volt’s main technologies to a domestic joint venture partner. Later that month, GM announced that it would develop electric cars in China with its existing joint venture partner, SAIC, and would transfer battery and other EV technology to the venture. Although Chinese officials deny the allegation that China forces foreign companies to transfer technology in exchange for access to the Chinese market, such incidents only add to the concerns that foreign companies have doing business in China.¹³²

Tire Imports: Safeguard Provisions (Section 421)¹³³

As part of the 2001 WTO accession agreement, China agreed to let the United States continue to treat it as a non-market economy for 12 years (codified in U.S. law under Section 421 of the 1974 Trade Act, as amended) for the purpose of safeguards. This provision allows the United States to temporarily impose restrictions (quotas and/or increased tariffs) on imported Chinese products that have increased in such quantities that they cause, or threaten to cause, market disruption to U.S. domestic manufacturers. There were six Section 421 cases filed during the Administration of George W. Bush, none resulting in safeguard measures being imposed under this China-specific provision.

On April 20, 2009, the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union (USW or “United Steel Workers”) filed a petition with the U.S. International Trade Commission (USITC) claiming that certain low-priced U.S. imports of passenger vehicle and light truck tires from China caused or threatened to cause market disruption to the domestic tire producers of similar or directly competitive items, and that the \$1.8 billion worth of automotive tires from China had caused the loss of more than 5,000 U.S. jobs.¹³⁴ U.S. tire manufacturers did not support the case, while many tire dealers feared a drop-off in demand when prices went up.¹³⁵

¹³¹ *Financial Times*, “Beijing Presses Carmakers to Share Technology,” February 18, 2011.

¹³² *The New York Times*, “Hybrid in a Trade Squeeze,” September 5, 2011; “GM Plans to Develop Electric Cars with China,” September 20, 2011; and *Automotive News China*, “GM resists Chinese pressure to share EV technology,” September 8, 2011; “China Says It Won’t Force Foreign Automakers to Share Technology,” February 10, 2012.

¹³³ For a recent legal analysis of this trade case, see CRS Report R40844, *Chinese Tire Imports: Section 421 Safeguards and the World Trade Organization (WTO)*, by Jeanne J. Grimmett.

¹³⁴ *The Wall Street Journal*, “U.S. to Impose Tariff on Chinese Tires,” Sept. 14, 2009; *The Detroit News*, “China Challenges U.S. Tire Tariffs,” September 15, 2009.

¹³⁵ *The Wall Street Journal*, “Burnt Rubber: Tire Firms Decry New Tariff,” September 30, 2009.

In June 2009, the USITC announced that it had determined that such imports did cause or threatened to cause market disruption, and recommended that the Obama Administration impose duties over three years (55% in the first year, 45% in the second, and 35% in the third). President Obama signed an order on September 11, 2009, to impose increased tariffs on top of an existing 4% duty, effective September 26, 2009. The tariff increase is 35% in the first year, 30% in the second year, and 25% in the third year, lower than those recommended by the USITC.¹³⁶

On September 14, 2009, China requested formal consultations at the WTO into the U.S. tariffs. When consultations didn't resolve the dispute, China requested a dispute settlement panel on December 21, 2009. A WTO dispute panel was appointed on March 12, 2010, marking this the first time that a WTO member's action under the China-specific safeguard became subject to a WTO panel review. On December 13, 2010, the WTO panel rejected all of China's claims in its report. China appealed the panel report in May 2011. In a report issued September 5, 2011, the WTO Appellate Body upheld all of the panel findings appealed by China.¹³⁷

In September 2009, China initiated an investigation into imports from U.S. poultry products and auto parts companies, alleging these were being unfairly dumped in the Chinese market and may also involve government subsidies. This move was viewed by many as retaliation over the U.S. action on Chinese tires.¹³⁸

Import Tariffs on U.S.-Built Vehicles

Viewed by many industry and trade experts as a retaliatory move over the U.S. safeguard measures on tires, the Chinese government launched an antidumping and anti-subsidy investigation into vehicles imported from the United States in October 2009. China claims that U.S. auto makers are being unfairly subsidized by the U.S. government.¹³⁹ GM, Chrysler, and the two related auto-financing units (GMAC/Ally Financial and Chrysler Financial) have received nearly \$80 billion from the U.S. government in loans, working capital, and other support funds.¹⁴⁰

In December 2011, China's Ministry of Commerce announced that China would impose antidumping and countervailing duties on U.S.-made sedans and sports utilities vehicles with

¹³⁶ *The Wall Street Journal*, "U.S. to Impose Tariff on Chinese Tires," September 14, 2009; *Financial Times*, "US Tyre Duties Spark China Clash," September 14, 2009.

¹³⁷ *Financial Times*, "China Turns to WTO in Trade Dispute," September 14, 2009; *The Detroit News*, "China Challenges U.S. Tire Tariffs," September 15, 2009; WTO Panel Report (WT/DS399/R); see http://docsonline.wto.org/imrd/gen_searchResult.asp?RN=0&searchtype=browse&q1=%28%40meta%5FSymbol+WT%FCDS399%FCR%2A+and+not+RW%2A%29&language=1; WTO Appellate Body Report (WT/DS399/AB/R): http://docsonline.wto.org/imrd/gen_searchResult.asp?RN=0&searchtype=browse&q1=%28%40meta%5FSymbol+WT%FCDS399%FCAB%FCR%2A+and+not+RW%2A%29&language=1. For additional information on the WTO China-specific safeguards and the 2009 China tires case, see CRS Report RL 40844, *Chinese Tire Imports: Section 421 Safeguards and the World Trade Organization (WTO)*, by Jeanne J. Grimmett.

¹³⁸ In August and September 2010, China imposed import tariffs on U.S. poultry of up to 105.4%. The USTR announced in December 2011 that the U.S. is requesting the WTO to establish a settlement panel to address the dispute. *Financial Times*, "China Turns to WTO in Trade Dispute," September 14, 2009; Bloomberg.com, "China Probes 'Unfair Trade' in U.S. Chicken and Auto Products," September 13, 2009; *The New York Times*, "China Imposes a Steep Tariff on U.S. Poultry," September 26, 2010. See CRS Report R40706, *China-U.S. Poultry Dispute*, by Renée Johnson, for more information of this China-U.S. poultry dispute case.

¹³⁹ *The Detroit News*, "China to Probe U.S. Carmakers," October 29, 2009.

¹⁴⁰ Ford Motor Co. did not receive federal assistance through TARP, the Troubled Asset Relief Program. For more information of the U.S. government assistance to the auto sector, see CRS Report R41940, *TARP Assistance for Chrysler: Restructuring and Repayment Issues*, by Baird Webel and Bill Canis and CRS Report R41978, *The Role of TARP Assistance in the Restructuring of General Motors*, by Bill Canis and Baird Webel.

engines of 2.5 liters and above, effective December 15, 2011. These duties will be levied on top of China's existing tariffs of 25% on all imported cars, regardless of country of origin. Countervailing duties are set to be 12.9% for GM and 6.2% for Chrysler; anti-dumping duties are set at 8.9% for GM and 8.8% for Chrysler. Some non-U.S. automakers also face duties, for example, the U.S. units of BMW and Daimler face antidumping duties of 2% to 2.7% respectively. The individual duties range from 2% to 21.5% and are set to expire in two years.¹⁴¹

To many industry and trade specialists, this move followed renewable energy trade disputes between China and the United States and appears largely symbolic.¹⁴² These duties are likely to have little material effect on American automakers because the automobile volume in dispute is limited.¹⁴³ Most foreign automakers have already based production in China for the majority of their cars sold to the Chinese market. For example, it has been reported that about 99% of GM vehicles sold within China are made in its Chinese factories. Ford reportedly said it would not be impacted by the tariff since it builds all of its Chinese vehicles locally, except Ford Edge, which it imports from Canada.¹⁴⁴

Other Developments

In January 2012, a coalition of labor and trade activists joined congressional Members from industrial states to push the Obama Administration to take action against what they described as surging imports of auto parts from China. They accused China of unfairly subsidizing its auto parts makers and illegally restricting the exports of crucial raw materials that foreign parts makers need to stay competitive. The coalition has been preparing legal briefs urging the Administration to file trade cases at the Commerce Department and dispute settlement cases with USTR to challenge a wide range of alleged Chinese subsidies for auto parts exporters and the Chinese rules to pressure American automakers to transfer the latest electric car technology in exchange of green-energy subsidies in China.¹⁴⁵

They have also urged the United States to challenge China's export restrictions on rare earths, which are necessary for production of many auto parts. On March 13, 2012, the United States, Japan, and the EU jointly initiated a WTO dispute settlement case against China's restrictive policies on rare earths and two other minerals. This case was brought shortly after the United States largely prevailed in a similar WTO case brought against China over its export restrictions on nine raw materials.¹⁴⁶

¹⁴¹ The Chinese Ministry of Commerce, Announcement No. 84, 2011 (in Chinese); <http://www.mofcom.gov.cn/aarticle/b/c/201112/20111207879064.html?3499642844=3438110436>, as viewed on May 29, 2012; Bloomberg.com, "China to Impose Anti-Dumping Duties on GM, U.S. Cars," December 14, 2011.

¹⁴² *Washington International Business Report*, December 2011, p.3; *China Daily*, "Trade Disputes to Become Hotter, But Won't Boil Over," May 30, 2012.

¹⁴³ *American Metal Market*, "China's Auto Import Duties 'Retaliation'," December 15, 2011; *Automotive News China*, "Chinese Import Tariffs on US-Built Vehicles Are Mostly Symbolic," December 16, 2011.

¹⁴⁴ *Financial Times*, "China to investigate US car subsidies," October 29, 2009: The United States exports about a totals of 30,000 vehicles to China annually (regardless of automaker or engine size), among which the Detroit Three account for 7,000 to 9,000 units; *Financial Times*, "China set to tax US-Made Car Imports," December 14, 2011.

¹⁴⁵ *The New York Times*, "Trade Protest Is Planned on Eve of a Chinese Leader's Visit," January 30, 2012; CNN Money, "Chinese Auto Parts Could Spark Next Trade Fight," January 31, 2012.

¹⁴⁶ For more discussion of these trade cases and China's export restrictions on certain raw materials, including rare earths, see CRS Report R42510, *China's Rare Earth Industry and Export Regime: Economic and Trade Implications for the United States*, by Wayne M. Morrison and Rachel Tang. Also, for additional information and broader discussion of trade issues between the United States and China, see CRS Report RL33536, *China-U.S. Trade Issues*, by Wayne M.

Morrison.

Concluding Thoughts

The Chinese auto industry, after the explosive growth during the past several years, has started to slow down. Car makers in China are likely to face intense competition and pressure on profitability amid falling demand and structural overcapacity in the industry. At the same time, the auto market remains lackluster in many European countries, due to the Euro zone financial crisis and related downturn in key markets, while the auto industry in the United States is starting to recover and become more competitive after restructuring. Although China has the ambition to make cars for the industrialized world, global acceptance of the quality and safety of Chinese automobiles remains a challenge for now.

Doubts remain if the central government's policies and measures to promote domestic automakers and indigenous brands, arguably at the expense of foreign automakers, are likely to help. Banning fleet purchases from foreign automakers may provide the domestic producers a captive (and limited) market but would not help them become more competitive with improved indigenous technology and brand recognition. Before it overcomes these issues, the Chinese auto industry is likely to go through a period of consolidation and restructuring.

A broader question is how effective the Chinese government's efforts would be to build globally competitive companies—whether its goals can be accomplished through government planning and directives or whether the Chinese auto companies should make their own business decisions and allow market forces to work.

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